

An Analysis of the Regulatory Burden on Small Banks

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Summary

Since the financial crisis, policymakers have focused on addressing the failures that led to turmoil and ensuring that the financial system and the economy are better positioned to withstand future market disruptions. Some believe that the actions taken to realize these goals have been beneficial; others argue that the pendulum of regulation has swung too far and that the additional regulation has stymied economic growth and reduced consumers' access to credit. Much of the debate has centered on how new regulation has affected small banks.

A central question about the regulation of small banks is whether an appropriate tradeoff has been struck between the benefits and costs of regulation. The benefits of financial regulation include protecting consumers from fraud, discrimination, and abuse; ensuring that banks are less likely to fail; and promoting stability in the financial system. The costs associated with government regulation and its implementation is referred to as *regulatory burden*. The concept of regulatory burden can be contrasted with the phrase *unduly burdensome*, which refers to the relationship between benefits and costs. Some would consider a regulation to be unduly burdensome if costs exceed benefits or if the same benefits could be achieved at lower costs. The presence of regulatory burden does not mean that a regulation is unduly burdensome. Critics who believe that regulation is unduly burdensome point to the significant decline in the number of small banks over time. There could be other factors driving consolidation, however. For example, mergers are the largest cause of consolidation, and could occur when banks are financially strong or weak.

Of the 14 “major” rules issued by banking regulators pursuant to the Dodd-Frank Act (P.L. 111-203), 13 either include an exemption for small banks or are tailored to reduce the cost for small banks to comply. In addition, during the rulemaking process, financial regulators are required to consider the effect of rules on small banks. Supervision and enforcement are also structured to pose less of a burden on small banks than larger banks, such as by requiring less frequent bank examinations for certain small banks. This report provides several examples that could be offered to counter views that there is a “one-size-fits-all” approach to bank regulation and that new regulation has increased regulatory burden relative to large banks. If small banks are facing unduly burdensome regulation, it is either in absolute terms or because small banks have less capacity for regulatory compliance than large banks do.

Quantifying the magnitude of regulatory burden has been a challenge for researchers because, among other reasons, federal statute does not require regulators to make quantitative estimates for all rules that they issue and because banks do not track the compliance costs spread throughout their operations. The difficulty in accurately assessing regulatory burden and in determining whether the burden rises to being unduly burdensome can make it challenging for policymakers to make informed judgments about the merits of proposals to provide regulatory relief.

The status quo is best characterized as applying ad hoc exemptions to certain regulations for banks based on their size and volume of activity, and most legislative proposals would adjust those exemption levels. Alternatives to the status quo range from regulating all banks in the same way, regardless of size, to implementing a separate regulatory regime for small and large banks, with various approaches in between. A focus on taxpayer protection and avoiding regulatory arbitrage would argue in favor of regulating all banks consistently. Rationales for regulating small banks differently from large banks include the systemic risk posed by large banks, economies of scale to regulatory compliance, a lack of critical mass of small banks to which some regulations would be relevant, and a desire by some policymakers to promote small banks.

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Introduction

In response to vulnerabilities that had arisen during the financial crisis that began in 2007, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act¹ (Dodd-Frank Act) to strengthen financial stability and protect consumers. As the Dodd-Frank Act and other reforms have been implemented through recent rulemaking by financial regulators, some in Congress have claimed that the pendulum has swung too far. They argue that the additional regulation has resulted in significant regulatory burden, particularly for small banks, that has stymied economic growth and reduced consumers' access to credit. A frequently heard critique is that the regulations are "one-size-fits-all," and are unduly burdensome to small banks even though they were not the cause of the crisis. Those who are sympathetic to this argument believe that because large banks pose greater risks to the stability of the overall financial system, small banks should be exempted from regulations that might be useful or necessary for large banks.

Others, however, view the current regulatory structure as having achieved the appropriate tradeoff between the benefits and costs of regulation, and are concerned that regulatory relief for banks or other financial institutions could negatively affect consumers and market stability.

This report explains the concept of regulatory burden and the different ways it can be manifested. It analyzes whether small banks are *relatively* more burdened by regulation than big banks. To help answer that question, the report looks at the relative treatment of small and large banks in recent major regulatory proposals. It does not attempt to answer the question of whether small banks face too much or too little regulation in *absolute* terms, since that depends on policymakers' judgments about balancing financial stability, credit availability, consumer protection, and other objectives. The report also evaluates rationales for reducing the regulatory burden on small banks relative to large banks, policy approaches to do so, and the potential consequences on other market participants of providing relief to small banks.

What is Regulatory Burden?

Financial regulation can result in both benefits and costs. The benefits of financial regulation—discussed in more detail in the section "Who Regulates Banks and What Do Regulators Do?"—include protecting consumers from fraud, discrimination, and abuse; ensuring that banks are less likely to fail; and promoting stability in the financial system. The cost associated with government regulation and its implementation is referred to as *regulatory burden*.

In the banking world, regulatory burden can be borne by banks, consumers, the government, and the economy at large. For example, under the Ability-to-Repay² requirement of the Dodd-Frank Act, a lender must verify that a borrower has the ability to repay a mortgage prior to offering the mortgage. The bank may face higher costs because it now must train its staff how to properly apply the rule and may spend more time reviewing each application. Some of this cost may be passed on to consumers through higher interest rates and fees or fewer lending options. The government may bear costs associated with writing rules to implement the statutory requirement and examining lenders to ensure that they are complying with the rules.³ Regulatory burden could

¹ P.L. 111-203.

² For more information, see CRS Report R43081, *The Ability-to-Repay Rule: Possible Effects of the Qualified Mortgage Definition on Credit Availability and Other Selected Issues*, by Sean M. Hoskins.

³ Because the operations of financial regulators are financed through fees and assessments on regulated institutions, any increase in the cost of conducting regulation may be passed on to banks.

result in fewer mortgages being originated, which in turn could affect the broader economy through fewer home sales and reduced construction on new homes. The rule may have benefits—ensuring that borrowers are more likely to receive mortgages that they can repay—but there are also costs.

Regulatory burden on banks is manifested primarily in two different ways, operating costs and opportunity costs.⁴ *Operating costs* (or *compliance costs*) are the costs the bank must bear in order to comply with regulation. For example, in response to a new rule, a bank may spend more money training its employees to ensure they understand the new rules, and the bank may have to purchase updated computer programs because the new rule defines concepts in ways that are incompatible with its old systems. Updating computer programs is an example of operating costs that are one-time costs borne upfront. Other costs, such as hiring additional compliance officers, are recurring costs that exist so long as the requirement is in effect. *Opportunity costs* are the costs associated with foregone business opportunities because of the additional regulation. A bank may, for example, offer fewer mortgages because new regulations make mortgage lending more expensive and instead choose to perform a different type of activity that is now more profitable.

Regulatory burden can influence where in the broader financial system a certain activity will be performed. Small-dollar loans, for example, can be offered by both banks and nonbank institutions (i.e., financial institutions that do not accept deposits), such as payday lenders. If a new regulation for small-dollar loans only applies to banks or it applies to both banks and nonbanks but it is less costly for nonbanks to comply, nonbanks would be expected to perform a larger share of small dollar loans. A comprehensive assessment of the broader societal costs and benefits of a regulation would need to include how the financial system adapts and responds to the regulation, which is beyond the scope of this report.

Much of this report focuses on the costs of regulation borne by banks. However, the presence of regulatory burden does not speak to the relationship between costs and benefits, and thus does not necessarily mean that a regulation is undesirable or should be repealed. A regulation can have benefits that could outweigh costs, but the presence of costs means, tautologically, that all regulations result in regulatory burden.

The concept of regulatory burden can be contrasted with the phrase *unduly burdensome*. Whereas regulatory burden generally refers to the costs associated with a regulation, unduly burdensome

Regulatory Burden Versus Unduly Burdensome

The concept of *regulatory burden* can be contrasted with the phrase *unduly burdensome*. Whereas regulatory burden is about the costs associated with a regulation, unduly burdensome refers to the relationship between the benefits and costs of a regulation. All regulations result in regulatory burden, but policymakers are divided over which regulations, if any, are unduly burdensome.

refers to the relationship between the benefits and costs of a regulation. For example, some would consider a regulation to be unduly burdensome if costs are in excess of benefits or if the same benefits could be achieved at lower costs. But the mere presence of regulatory burden does not mean that a regulation is unduly burdensome. Policymakers that advocate for providing banks with relief from a regulation often do so because they believe the regulation is unduly burdensome, not just because it imposes a regulatory burden. Critics of a relief proposal typically accept that the regulation causes regulatory burden, but would likely argue that the burden does not rise to the level of being unduly burdensome because the benefits of the regulation justify its implementation.

⁴ Gregory Elliehausen, *The Cost of Bank Regulation: A Review of the Evidence*, Board of Governors of the Federal Reserve System, April 1998, p. 3, at <http://www.federalreserve.gov/pubs/staffstudies/1990-99/ss171.pdf>.

To provide the context necessary to understand the regulatory burden on small banks, the next two sections explain what is meant by small bank and describe how banks are regulated.

What is a Small Bank?

The term *bank* can be used to mean different things by different people, but this report will use the term bank as it is used in federal regulatory policy. Banks are a subset of *depository institutions*, which are issued specific business charters by their primary regulator that permit them to accept deposits.⁵ There are separate charters for commercial banks, thrifts (also called savings and loans, savings associations, and savings banks), and credit unions.⁶ A charter may be issued by a federal or state regulator. This report focuses on federal depository institutions that are not credit unions and refers to them collectively as banks, unless otherwise noted.

Banks are typically classified as small or large based on their total asset size (i.e., the value of the loans and securities they hold), but there is no standard, commonly accepted threshold for what asset size constitutes a small bank. Some researchers define small as \$1 billion or less in assets, whereas others define it as \$10 billion or less. The Federal Reserve defines community banks as those banks with less than \$10 billion in assets.⁷ Often, the term *community bank* is used as a synonym for small bank. The Office of the Comptroller of the Currency (OCC) defines community banks as generally having \$1 billion or less in assets.⁸ Others define community bank by combining size with a focus on relationship-based services, such as lending, with the local community. The Federal Deposit Insurance Corporation (FDIC) has a research definition of community banking organizations, which it defines as (1) banks with less than \$1 billion in assets as long as the bank makes loans and takes deposits, does not hold a large share of foreign assets, and is not a specialty bank; or (2) banks with more than \$1 billion in assets that meet certain criteria, such as having more than one-third of their assets in loans, core deposits equal to at least half of their assets, and a limited geographical presence.⁹ By this definition, not all small banks are community banks, and not all community banks are small banks, although the two are closely related.¹⁰ Typically, the size of the bank is measured at the depository subsidiary level. Counterintuitively, this definition means that some very large and complex financial institutions own subsidiaries that qualify as small banks. *This report will use the terms small bank and community bank loosely because there is no widely accepted definition.*

The terms small bank and community bank as commonly used encompasses a disparate group of institutions, varying in size, activities, and charter. Asset size is not the most intuitive concept to understand what is meant by a small bank. To provide some additional perspective on the size of small institutions, it is informative to look at the number of employees at institutions of different asset sizes. At the end of 2014, a bank with approximately

⁵ Foreign banks with certain U.S. charters are permitted to accept deposits and make loans in the United States, similar to a domestic bank. Other foreign banks are not, and are beyond the scope of this report.

⁶ More specialized charters exist as well that are beyond the scope of this report.

⁷ See, e.g., Board of Governors of the Federal Reserve System, *Community Banking*, at http://www.federalreserve.gov/bankinfo/topics/community_banking.htm.

⁸ See, e.g., Office of the Comptroller of the Currency (OCC), *Community Bank Supervision: Comptroller's Handbook*, January 2010, at <http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/cbs.pdf>.

⁹ See, e.g., Federal Deposit Insurance Corporation (FDIC), *FDIC Community Banking Study*, December 2012, at <https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf>.

¹⁰ Thus, if the policy goal is to reduce regulatory burden on community banks rather than small banks, then the approaches discussed in this report based on bank size would not be the best way of achieving the policy goal.

- \$100 million in assets had, on average, 25 employees,¹¹
- \$1 billion in assets had, on average, 214 employees,¹² and
- \$10 billion in assets had, on average, 1,173 employees.¹³

These estimates might be larger than what a lay person would think of as a small institution. Notably, the average number of employees at a bank with \$10 billion in assets is more than double the Small Business Administration's research definition of a small business as having 500 employees or less.¹⁴

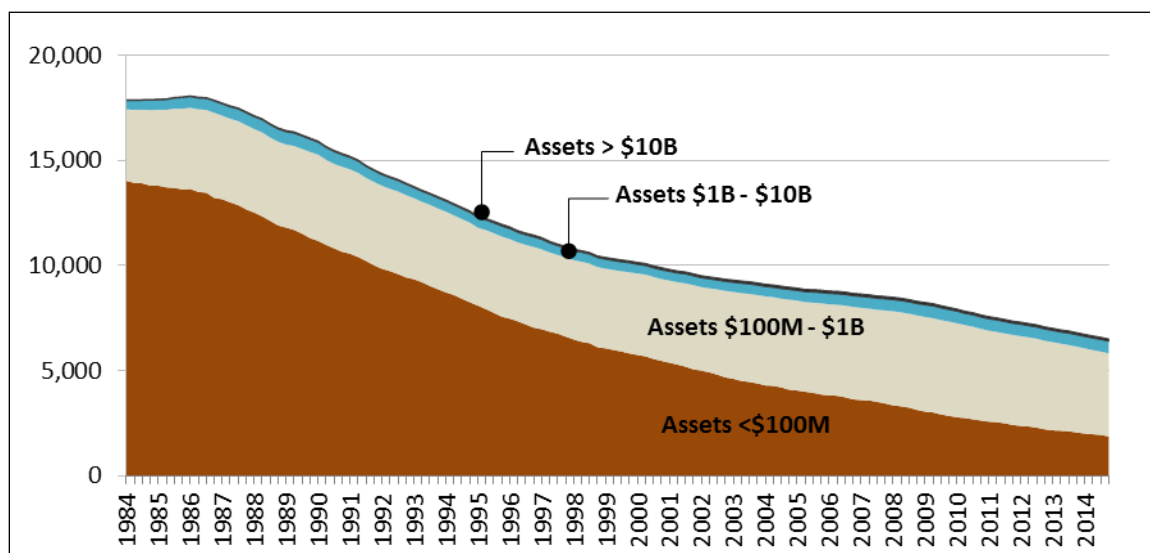
Small banks, under almost any common definition, have seen their numbers dwindle and their collective share of banking industry assets fall in recent decades. As **Figure 1** illustrates, there has been a long-term decline in the number of small banks in the United States, and, as shown in **Figure 2**, a long-term increase in the share of assets held by the largest banks. Overall, the number of institutions has fallen from a peak of 18,083 in 1986 to 6,509 in 2014. The number of banks with more than \$10 billion in assets, shown in blue at the top of **Figure 1**, has nearly quadrupled in that time period, from 28 in 1984 to 107 in 2014. The number of banks with assets between \$1 billion and \$10 billion has been relatively stable over the past three decades, as has the number of banks with assets between \$100 million and \$1 billion. The most dramatic change has been in the number of banks with less than \$100 million in assets, which has fallen from approximately 14,000 institutions in 1984 to 1,872 at the end of 2014.

¹¹ Congressional Research Service (CRS) estimate based on data from the FDIC, "Statistics on Depository Institutions," at <https://www2.fdic.gov/sdi/>. There are 449 banks with between \$90 million and \$110 million in assets that have a total of 11,270 full-time equivalent employees.

¹² CRS estimate based on data from the FDIC, "Statistics on Depository Institutions," at <https://www2.fdic.gov/sdi/>. There are 145 banks with between \$900 million and \$1.1 billion in assets that have a total of 31,013 full-time equivalent employees.

¹³ CRS estimate based on data from the FDIC, "Statistics on Depository Institutions," at <https://www2.fdic.gov/sdi/>. There are 17 banks with between \$9 billion and \$11 billion in assets that have a total of 19,941 full-time equivalent employees.

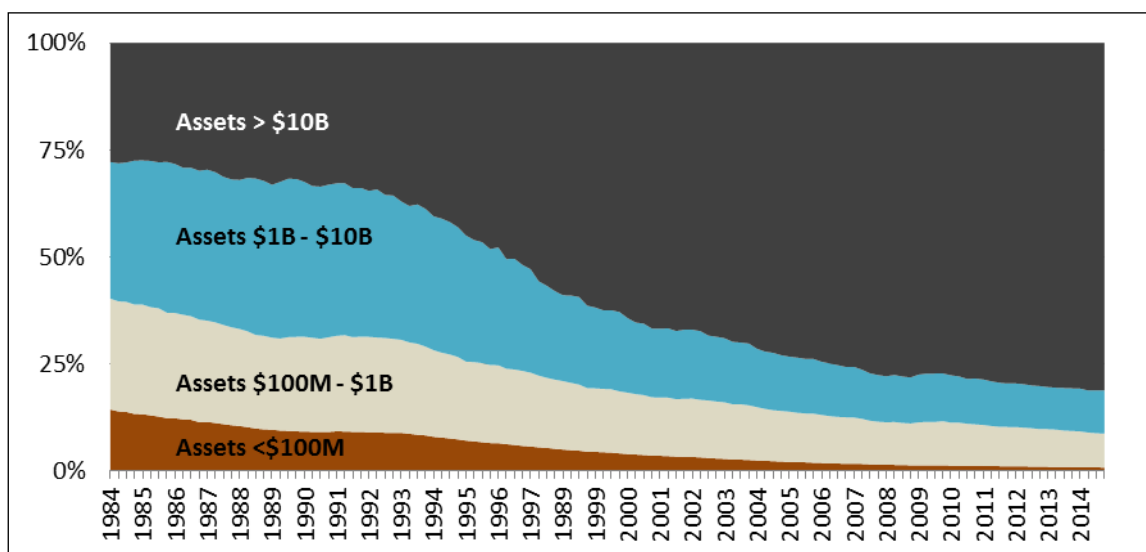
¹⁴ See <https://www.sba.gov/advocacy/firm-size-data>. The SBA uses various different definitions of small business for eligibility for its programs. For more information, see CRS Report R40860, *Small Business Size Standards: A Historical Analysis of Contemporary Issues*, by Robert Jay Dilger.

Figure 1. Number of Banking Institutions, 1984-2014

Source: Figure created by CRS using data from the FDIC.

Note: Banks with assets greater than \$10 billion is the small blue line at the top of the graph.

The number of banks with more than \$10 billion in assets has increased, as well as their share of total banking industry assets, from less than 30% in 1984 to more than 80% in 2014, as **Figure 2** shows. The share of industry assets held by the smaller categories of banks has decreased over that time period.

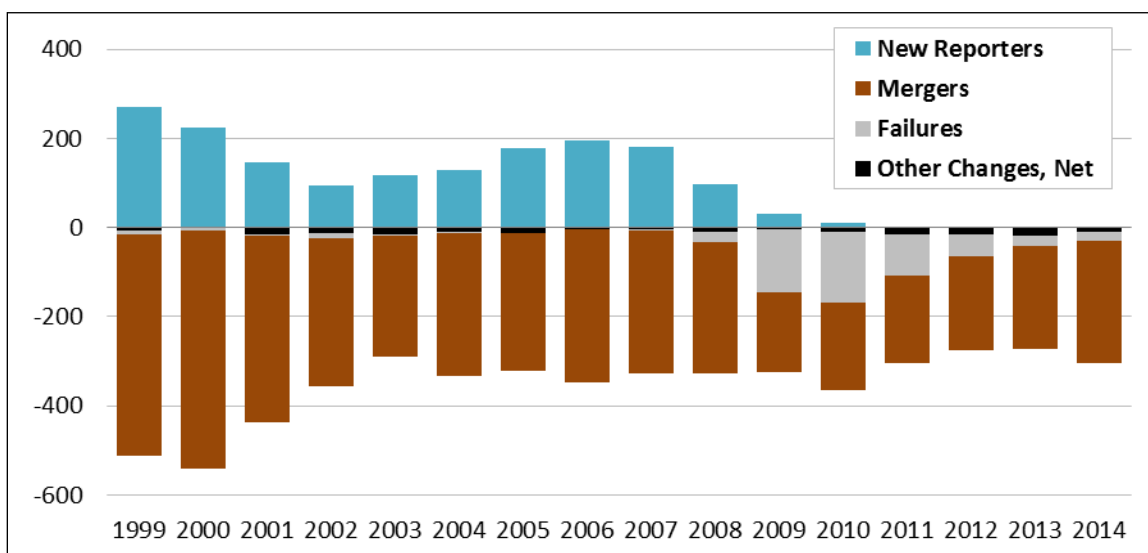
Figure 2. Share of Industry Assets by Different Categories, 1984-2014

Source: Figure created by CRS using data from the FDIC.

The decrease in the number of banks from 9,904 in 2000 to 6,509 in 2014 has three main causes. Most of the decline in the number of institutions in that time period has been due to mergers (274 in 2014), as shown in **Figure 3**. Failures were minimal from 1999 to 2007, but played a larger role in the decline during the financial crisis and recession. As economic conditions have improved more recently, failures have declined (there were 18 in 2014). The number of “New

Reporters,” institutions providing information to the FDIC for the first time, has decreased in recent years and was zero in 2014 because there were no newly chartered banks.

Figure 3. Changes in the Number of FDIC-Insured Institutions, 1999-2014



Source: Figure created by CRS using data from the FDIC.

Note: “Other Changes, Net” includes charter conversions, voluntary liquidations, adjustments for open-bank assistance transactions, and other changes.

Some would take this industry consolidation to indicate that the regulatory burden on small banks has been onerous. Mergers—the largest factor in consolidation each year from 1999 to 2014—could take place from a position of strength or weakness, however. For example, a bank that is struggling financially may look to merge with a stronger bank in order to stay in business. Alternatively, a small bank that has been outperforming its peers may be bought by a larger bank that wants to benefit from its success. There are other fundamental changes in the banking system that are likely driving consolidation, making it difficult to isolate the effects of regulation.¹⁵ First, the legal authority to bank across state lines was highly restricted through much of the twentieth century, and not entirely liberalized until 1997 as a result of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.¹⁶ Second, there may be economies of scale (cost advantages due to size or volume of output) to banking, and they may be growing over time. For example, information technology has become more important in banking (e.g., cybersecurity and mobile banking), and certain information technology systems may be subject to economies of scale.¹⁷ Third, the slow growth coming out of the most recent recession and macroeconomic

¹⁵ The head of a 2007 inter-agency study on regulatory burden stated that “it is difficult to accurately measure the impact regulatory burden has played in industry consolidation....” Federal Financial Institutions Examination Council (FFIEC), *Joint Report to Congress: EGRPRA*, July 31, 2007, p. 3, at <http://egrpra.ffiec.gov/docs/egrpra-joint-report.pdf>. A 2014 study looked at the effect of regulatory burden on new charters and found that at least 75% of the decline could be attributed to macroeconomic conditions; see Robert M. Adams and Jacob P. Gramlich, *Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation*, Federal Reserve Board, December 16, 2014, at <http://www.federalreserve.gov/econresdata/feds/2014/files/2014113pap.pdf>.

¹⁶ P.L. 103-328. For more on its effect on consolidation, U.S. Government Accountability Office (GAO), *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings*, GAO-12-881, September 2012, at <http://www.gao.gov/assets/650/648210.pdf>.

¹⁷ The presence of economies of scale in banking has not been proven and is the subject of extensive research. See e.g.,

conditions more generally, such as low interest rates, may make it less appealing for new entrants to enter the banking market. This report does not assess the extent to which industry consolidation is reflective of weakness in the financial performance of small banks, nor does it assess the financial status of small banks more broadly.

Who Regulates Banks and What Do Regulators Do?

The focus on regulatory burden in banking stems, in part, from the unique nature of banking regulation. As described in a CRS report, “Banking is one of the most heavily regulated businesses in the United States. Nearly every aspect of the operation and management of an insured institution is subject to close regulatory supervision.”¹⁸ The Supreme Court once characterized the regulation of depository institutions as extending from an institution’s cradle to its corporate grave.¹⁹ Unlike the regulation of many other industries, supervision is carried out continuously and the statutes that banks must comply with cover a wider scope of policy areas, which will be discussed in this section.

To understand who regulates banks and how, it is important to consider what is meant by “regulation,” broadly. Regulation can be thought of as having three distinct components: rulemaking, supervision, and enforcement.

1. *Rulemaking* refers to the process federal agencies follow to issue rules, pursuant to a grant of authority from Congress, and the end result of that process (i.e., the regulations that are issued).
2. *Supervision* refers to the power to examine banks, instruct banks to modify their behavior, and to impose reporting requirements on banks to ensure compliance with rules. In some cases, examiners confirm whether banks meet quantitative targets and thresholds set by regulation; in others, they have discretion to interpret whether a bank’s actions satisfy the goals of a regulation.
3. *Enforcement* is the authority to take certain legal actions, such as imposing fines, against an institution that fails to comply with rules and laws.

Regulatory burden can occur through all three channels. For example, how much staff and resources are devoted to complying with a rule? How do banks’ activities change when a new rule is adopted? How often should supervisory examinations occur and how long should they take? Do other banks adjust their behavior in response to an enforcement action against a peer?

In general, banking regulation can be thought of as divided into two main categories: (1) safety and soundness regulation and (2) consumer protection regulation.²⁰

Safety and Soundness Regulation. Safety and soundness, or prudential, regulation is designed to ensure that a bank maintains profitability and avoids failure. To do so, regulators monitor the bank’s risk profile and set various metrics that banks must maintain in areas such as capital and liquidity. Banks are assigned one of three prudential federal regulators based on their charter and corporate structure, as summarized in **Table 1**.

Federal Deposit Insurance Corporation, *FDIC Community Banking Study*, December 2012, pp. 5-22, at <https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf>.

¹⁸ CRS Report RL33235, *Banking and Securities Regulation and Agency Enforcement Authorities*, by Mark Jickling et al.

¹⁹ *Fidelity Federal Savings and Loan Association v. De La Cuesta*, 458 U.S. 141 (1982).

²⁰ For a full analysis, see CRS Report R43087, *Who Regulates Whom and How? An Overview of U.S. Financial Regulatory Policy for Banking and Securities Markets*, by Edward V. Murphy.

Table 1. Federal Prudential Regulators of Depositories

Primary Regulator	Banking Institutions Supervised
Federal Deposit Insurance Corporation (FDIC)	state banks that are not members of the FRS, state savings associations
Federal Reserve (Fed)	bank holding companies, state banks that are members of the FRS, savings and loan holding companies
Office of the Comptroller of the Currency (OCC)	national banking associations, federal savings associations
National Credit Union Administration (NCUA)	federally chartered or federally insured credit unions

Source: CRS based on 12 U.S.C. 1813(q)

Note: FRS = Federal Reserve System. This table does not include foreign banks or non-banks regulated by these agencies.

Different parts of the same banking organization may be overseen by different regulators, but each bank (or part of the bank) is assigned a primary federal regulator to reduce regulatory duplication. Jurisdictional overlap exists because of the historical evolution of the regulatory system. State banks are assigned a primary federal regulator, but are regulated at the state level as well. Credit unions are subject to a separate regulatory regime and are regulated by the National Credit Union Administration (NCUA). Differences in regulation between banks and credit unions are beyond the scope of this report.

Banks are federally regulated for safety and soundness for multiple reasons,²¹ including ensuring that taxpayer funds, which ultimately back federal deposit insurance and the Fed's discount window, are safeguarded. Economists believe that access to a government backstop creates a moral hazard problem, meaning that federal backing gives a bank's creditors (such as depositors) less incentive to monitor the risks that the bank is taking. Prudential regulation can mitigate greater risk taking in the presence of moral hazard.

In principle, there is generally considered to be a short-run trade-off²² between the safety and stability of banks and the cost and availability of bank credit. If regulation that is intended to make it less likely that a bank fails also increases the cost of offering loans and providing other services, a bank may reduce how much of its services it is willing to provide or consumers may be less willing to consume as much of the services because of the higher prices that could be passed on to them. It is also possible that additional prudential regulations that result in more costly services would result in activity migrating out of the relatively more regulated part of the financial system to less regulated parts of the system.²³

Consumer Protection Regulation. Consumer protection focuses on ensuring that institutions conform to applicable consumer protection and fair-lending laws. Prior to the Dodd-Frank Act,

²¹ Since the crises, some policymakers have emphasized systemic risk (macroprudential) regulation—the stability of the overall financial system—as distinct from safety and soundness (microprudential) regulation, which focuses on the stability of an individual institution. This topic is discussed in detail in the “Systemic Risk” section below.

²² A completely unregulated system may result in both an unstable system and one in which there is a high cost of credit, however. Prudential regulation could therefore result in gains to both. Assuming that existing regulation has achieved a stable system, many argue that additional regulations are likely to lead to a tradeoff between the safety and stability of banks and the cost and availability of bank credit.

²³ For overview of shadow banking, see CRS Report R43345, *Shadow Banking: Background and Policy Issues*, by Edward V. Murphy.

the prudential banking regulators were charged with the two-pronged mandate of regulating both for safety and soundness and for consumer protection. Pursuant to the Dodd-Frank Act, the Consumer Financial Protection Bureau (CFPB)²⁴ acquired certain consumer protection powers over banks that vary based on whether a bank holds more or less than \$10 billion in assets.

For banks with *more than \$10 billion* in assets, the CFPB is the primary regulator for consumer protection, whereas safety and soundness regulation continues to be performed by the prudential regulator. As a regulator of larger banks, the CFPB has rulemaking, supervisory, and enforcement authorities. This means the CFPB can issue rules for a large bank to follow, examine the bank to ensure it is in compliance with these rules, and take enforcement actions (such as imposing fines) against banks that fail to comply. A large bank, therefore, has different regulators for consumer protection and safety and soundness.

For banks with *\$10 billion or less* in assets, the rulemaking, supervisory, and enforcement authorities for consumer protection are divided between the CFPB and the prudential regulators. The CFPB may issue rules that would apply to smaller banks from authorities granted under the federal consumer financial protection laws. The prudential regulator, however, would maintain primary supervisory and enforcement authority for consumer protection. The CFPB has limited supervisory authority over smaller banks; it can participate in examinations of smaller banks performed by the prudential regulator “on a sampling basis.”²⁵ Although the CFPB does not have enforcement powers over small banks, it may refer potential enforcement actions against small banks to the banks’ prudential regulators. (The prudential regulators must respond to such a referral but are not bound to take any other substantive steps.)

One of the long-standing issues in the regulation of consumer financial services is the perceived trade-off between protecting consumers and ensuring that providers of financial services are not unduly burdened. If regulation intended to protect consumers increases the cost of providing a financial product, a company may reduce how much of that product it is willing to provide and to whom it is willing to provide it. Those who still receive the product may benefit from the enhanced disclosure or added legal protections of the regulation but at the cost of a potentially higher price.

Other Forms of Regulation. In addition to safety and soundness regulation and consumer protection regulation, banks are also regulated for anti-money laundering, community reinvestment, as well as for a host of other things. The Treasury Department also issues some regulations with which banks must comply, such as economic sanctions. To the extent that banks participate in securities and derivatives markets, they are subject to activities-based regulations issued by the Securities Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC). Although there is regulatory burden associated with all of these areas, this report primarily addresses the regulatory burden associated with the activities of the banking regulators.

Characteristics Determining the Regulatory Burden a Bank Faces

Congressional debate on regulatory burden often emphasizes issues related to bank size, which will be discussed in detail in the rest of the report. Size is only one of several factors that

²⁴ For additional information, see CRS Report R42572, *The Consumer Financial Protection Bureau (CFPB): A Legal Analysis*, by David H. Carpenter.

²⁵ P.L. 111-203, §1026.

influences burden, however. The regulatory burden borne by a bank depends on *what* rules are applied to it (rulemaking) and *how* those rules are applied (supervision and enforcement). The factors that determine what rules are applied and how include the following:

- **Charter**—Because a bank’s primary regulator depends on its charter, to the extent that different bank regulators have different practices and policies, the charter will influence the regulatory burden. However, to reduce disparate treatment between regulators, the OCC, FDIC, and Fed often undertake joint rulemaking and participate in an interagency council, the Federal Financial Institutions Examination Council (FFIEC), established by Congress to “prescribe uniform principles and standards for federal examination of financial institutions”²⁶ and create standardized reporting forms. FFIEC consists of representatives from the OCC, Fed, FDIC, NCUA, CFPB, and a state regulator. State regulators can issue regulations that apply to state banks, as long as they do not conflict with federal law. State chartered banks have a state and primary federal regulator (either the FDIC or Fed). If the bank has a state charter, supervisory examinations can alternate between the state banking regulation and its primary federal regulator.²⁷ Differences in regulation and regulatory burden between banks and credit unions are a perennial concern of Congress, but beyond the scope of this report.
- **Risk profile**—Not all banks pose the same risk of failure, risk to consumers, and risk to the overall system, so policymakers tailor some regulations and supervisory practices by risk profile in order to reduce regulatory burden. For example, because small banks with higher supervisory ratings—signaling that they are perceived to be healthier—are, all else equal, less likely to fail, they are examined less frequently and intensely than banks with lower ratings.²⁸
- **Business model**—Certain activities will attract more regulatory scrutiny than others because they are riskier, more complex, pose more risk to consumers or the broader economy, and so on. Different banks offer different types of services and engage in different types of activities; therefore, some banks will have greater regulatory compliance costs because they are involved in more activities or lines of businesses that require oversight. In other words, the same activity will require a certain amount of regulatory compliance at any bank that undertakes it, but some banks will undertake more of that activity than others, which will result in proportionately more regulatory burden. Notably, if banks engage in certain activities, such as operating in the securities or derivatives market, it will trigger additional activity-based regulation.

²⁶ 12 U.S.C. 3208. For more information, see FFIEC, “About the FFIEC,” at <http://www.ffiec.gov/about.htm>.

²⁷ FDIC Office of Inspector General, *The FDIC’s Examination Process for Small Community Banks*, AUD-12-011, August 2012, p. 2, at <http://www.fdicog.gov/reports12/12-011AUD.pdf>.

²⁸ See Federal Reserve System, Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of \$10 Billion or Less, SR 13-21, December 17, 2013, at <http://www.federalreserve.gov/bankinforeg/srletters/sr1321.htm>. CAMELS ratings are the rating system that serve as the basic safety and soundness standards used by bank regulators. For more information, see Jose A. Lopex, Using CAMELS Ratings to Monitor Bank Conditions, Federal Reserve Bank of San Francisco, June 1999, at <http://www.frbsf.org/economic-research/publications/economic-letter/1999/june/using-camels-ratings-to-monitor-bank-conditions/>.

The factors listed above can be correlated to different degrees with size. Size and *charter* are not closely correlated among the three federal bank regulators, in the sense that there is not a predominantly “big bank” or “small bank” regulator. Each is the primary regulator of at least 100 banks with more than \$1 billion in assets and at least 700 banks with less than \$1 billion in assets.²⁹ In absolute terms, the FDIC regulates the most banks over and under \$1 billion in assets. Just as there are small and large banks regulated by each bank regulator, size is not the only factor determining whether to charter as a bank or credit union. Most credit unions are small, but there are also over 200 credit unions with more than \$1 billion in assets, of which only 5 with more than \$10 billion in assets. There is only one credit union with more than \$50 billion in assets.³⁰

It is difficult to draw any conclusions about the correlation between size and *risk profile* because information on supervisory ratings is confidential. Both small and large banks became financially distressed during and after the financial crisis. Looking at the correlation between size and measures such as capital ratios gives an incomplete picture of risk profile.

Size is somewhat correlated with *business model* in terms of the types of activities that large and small banks engage in. On average, small banks devote more of their activities to the traditional business model of taking deposits and making loans than large banks. The FDIC’s definition of community bank can be used as a proxy for a traditional banking business model. As of the end of 2010, the FDIC found that 92 of 6,286 institutions with less than \$1 billion in assets did not meet the FDIC’s criteria of “community bank,” which is defined in such a way that a certain percentage of the banks activities must be lending and deposit taking. By contrast, 298 of 628 institutions with more than \$1 billion in assets did not meet the definition of community banks; these institutions held \$11.3 trillion of \$13.3 trillion in total industry assets.³¹

While there is no simple metric for determining the complexity of a bank’s business model, a comparison of data from the bank holding company peer reports can be used as an example of the extent to large banks are more involved in more complex activities than small banks. For example, banks with less than \$500 million in assets are less likely than banks with more than \$10 billion in assets to have non-bank subsidiaries, such as broker-dealers, use derivatives, guarantee credit derivatives, have foreign activities, or fund themselves with other types of debt than deposits.³²

Differences in How Small and Large Banks Are Regulated

As mentioned in the previous section, size is one of the factors that policymakers may consider in deciding whether to apply certain regulations to a bank and how a bank should be supervised. This section provides an overview of how small banks are regulated compared to larger banks.

Some argue that there is a one-size-fits-all model of regulation. One recent whitepaper opined, “The major flaw of the federal banking regulatory system is that it treats a community bank with \$165 million in assets (the median-sized American bank) as the same essential creature as JP

²⁹ CRS data query from FDIC’s Statistics on Depository Institutions, available at <https://www2.fdic.gov/sdi/index.asp>.

³⁰ As of June 30, 2014. Source: <http://www.americanbanker.com/rankings/cus-most-assets-1072621-1.html>.

³¹ Table 1.2 of <https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf>.

³² CRS analysis of National Information Center, Bank Holding Company Peer Reports, fourth quarter of 2014, available at http://www.ffiec.gov/nicpubweb/content/BHCPRRPT/BHCPR_Peer.htm.

Morgan Chase or Bank of America.”³³ Echoing a similar sentiment, Federal Reserve Governor Daniel Tarullo has described banking regulation as historically following a “unitary model,” which he describes as a system where the broad principles underlying bank regulation are the same for all banks, regardless of their size and activities. A unitary approach to bank regulation was justified on the grounds that the basic rationale for safety and soundness regulation is to protect taxpayers in the presence of federal deposit insurance. In other words, the primary goal of regulation is to minimize the likelihood that a bank failure will require an infusion of federal dollars to make insured depositors whole, regardless of whether the bank is small or large.³⁴

After the lessons learned from the financial crisis, however, Governor Tarullo argues that “the unitary approach of the pre-crisis period has been abandoned”³⁵ in the regulatory reforms of the last few years. He states that the Dodd-Frank Act and other reforms created “different categories of banking organizations—largely, but not exclusively, on the basis of total assets—to which different regulatory requirements are to apply.”³⁶ Part of the rationale for establishing different categories of banks is the acknowledgment that, should larger banks fail, they do not just pose a risk to taxpayers through the deposit insurance fund but also jeopardize the stability of the broader financial system. Because the risks banks pose may differ by size, the regulation those banks face should also differ. Community banks, Governor Tarullo argues, “will suffer the fallout from systemic problems, [but] are unlikely to cause such problems” and their regulation should reflect their lower level of risk relative to large banks.³⁷ Governor Tarullo does not argue that the existing regulatory approach for small banks is perfectly tailored and even suggests specific regulations that he believes may be applied unnecessarily to small banks, such as the Volcker Rule.³⁸ But, in general, Governor Tarullo argues that recent reforms have largely differentiated between banks based on size and provided exemptions to smaller banks.

The following assesses the arguments made by Governor Tarullo and others who argue that small banks have been largely exempt from recent regulatory actions by analyzing whether rulemaking, supervision, and enforcement are different for small and large banks.

Rulemaking

Rulemaking can be thought of as having two major components: the *content* of a rule and the *process* of issuing a rule.³⁹ Congress may require or permit regulators to favor small banks, or

³³ Tanya Marsh and Joseph Norman, “The Impact of Dodd-Frank on Community Banks,” American Enterprise Institute, white paper, 2013, p. 7, at https://www.stlouisfed.org/banking/community-banking-conference/PDF/Marsh_Norman_Reforming_Regulation.pdf.

³⁴ Gov. Daniel Tarullo, “A Tiered Approach to Regulation and Supervision of Community Banks,” speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

³⁵ Gov. Daniel Tarullo, “Rethinking the Aims of Prudential Regulation,” speech at the Federal Reserve Bank of Chicago Bank Structure Conference, May 8, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20140508a.htm>.

³⁶ Gov. Daniel Tarullo, “Rethinking the Aims of Prudential Regulation,” speech at the Federal Reserve Bank of Chicago Bank Structure Conference, May 8, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20140508a.htm>.

³⁷ Gov. Daniel Tarullo, “Rethinking the Aims of Prudential Regulation,” speech at the Federal Reserve Bank of Chicago Bank Structure Conference, May 8, 2014, <http://www.federalreserve.gov/newsevents/speech/tarullo20140508a.htm>.

³⁸ For more on the Volcker Rule, see CRS Report R43440, *The Volcker Rule: A Legal Analysis*, by David H. Carpenter and M. Maureen Murphy.

³⁹ For an introduction to the rulemaking process, see CRS Report IF10003, *Federal Regulations and the Rulemaking*

regulators may choose to do so independently, in the content of any given rule on a case-by-case basis. Alternatively, Congress may require regulators to give small banks special consideration through the rulemaking process any time a new rule is issued.

For the content of rules, small banks may be differentiated from large banks in the rulemaking process primarily through exemptions and tailoring.⁴⁰ In an *exemption*, the rule does not apply to small banks under some specified numerical threshold, but it does apply to larger banks. An exemption for certain types of banks can be specified in statute or, in some cases, included at the discretion of the regulator or regulators issuing the rule. With *tailoring*, a rule may apply to small banks and larger banks, but the rule is structured to reduce the regulatory burden on small banks by, for example, offering streamlined compliance options. Tailoring may be recommended by Congress, but the details are often worked out by the regulators. Asset size is the most commonly used threshold, but other metrics, such as liabilities, deposits, or activity volume, are also used. For both exemptions and tailoring, different rules have thresholds at different asset sizes, such as \$1 billion, \$10 billion, \$50 billion, and \$250 billion, as discussed below.

Exemptions and tailoring are different approaches to reducing regulatory burden with each having its own strengths and weaknesses. Tailoring is used when policymakers want to make sure that a requirement still applies to small banks, but would like to reduce the burden associated with complying. Regulators may, for example, reduce the amount of paperwork that small banks have to report about the requirement. Not all regulations, however, are appropriate for—or well targeted to—small banks. In such instances, an exemption may be more effective at balancing the benefits and costs of regulation. In particular, some are concerned that regulators may initially tailor a regulation appropriately so that it targets small banks without being unduly burdensome, but over time there may be a trickle-down of the standards that are applied to larger banks by regulators or other market participants so that they are, in practice, applied to small banks.⁴¹ Policymakers balance these tradeoffs in considering whether to include an exemption, tailoring, or neither in a regulation.

The next section provides several examples of long-standing regulations from which small banks have been exempted or received special tailoring. The following section (“Exemptions and Tailoring for Small Banks in Recent Rulemakings”) explains how small banks have been affected by more recent regulations. The section after that (“Special Consideration in Statute for Small Banks in the Rulemaking Process”) explains the different ways that small banks receive special consideration in the rulemaking process.

Examples of Longstanding Exemptions and Tailoring for Small Banks in Rules

Although many recent rules have exempted small banks (as discussed in the next section), adjusting rules based on size is not a new concept. Prior to recent financial reforms, small banks received exemptions from or special treatment for certain rules. For example, the Federal Reserve’s Small Bank Holding Company Policy Statement allows bank holding companies with less than \$1 billion in assets that meet certain criteria to hold more debt at the holding company

Process, by Maeve P. Carey and Daniel T. Shedd.

⁴⁰ Gov. Daniel Tarullo, “A Tiered Approach to Regulation and Supervision of Community Banks,” speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

⁴¹ For more on exemptions and tailoring, see Ron J. Feldman, *Supervision, Regulation, and Community Banks*, Federal Reserve Bank of Minneapolis, September 2014, at <https://www.minneapolisfed.org/publications/banking-in-the-ninth/supervision-regulation-and-community-banks>.

level than capital requirements would otherwise permit if the debt is used for acquisitions.⁴² This policy is motivated by recognition of differences between how small and large banks typically finance acquisitions. The policy statement is also, more recently, referenced in the “Collins Amendment” (Section 171) to the Dodd-Frank Act (P.L. 111-203) and the capital rule implementing Basel III.⁴³

In addition, reserve requirements are tailored in favor of small banks. Banks are required to hold cash reserves against their deposits⁴⁴ in their vaults or at the Federal Reserve. The percentage of reserves that banks are required to hold against deposits is graduated based on the amount of deposits they hold. In 2015, banks do not have to hold any reserves for their first \$14.5 million in deposits; from \$14.5 million to \$103.6 million of deposits, banks are required to hold reserves equal to 3% of deposits; and for deposits over \$103.6 million, banks are required to hold reserves equal to 10% of deposits. Because reserves earn little income, lower reserve requirements for small banks allow them to use relatively more of their deposits to finance more profitable activities.

As another example, banks with assets of less than \$500 million or \$1 billion, depending on the provision, are also exempted from FDIC regulations and provisions of the Sarbanes-Oxley Act of 2002 (in the case of publicly traded banks) subjecting banks to certain corporate governance requirements pertaining to independent auditing, financial reporting, and internal controls. Exemptions were provided from some of these requirements because of concerns about regulatory burden.⁴⁵

These examples illustrate that, even though some have characterized the past regulation of banks as following a unitary model, rules with exemptions and tailoring based on the size of the institution have long existed. Arguably, what has changed recently is that exemptions and tailoring are being applied with greater frequency. It is an open question whether the exemptions from more recent rulemakings, described in the next section, are best characterized as a continuation of a previous trend of altering regulations based on size or as a paradigm shift that has resulted in the abandonment of the unitary regulatory approach altogether.

Exemptions and Tailoring for Small Banks in Recent Rulemakings

An evaluation of how small banks have been affected by new rulemaking in recent years is hindered by both the sheer number of new rules and the fact that the effects of rules cannot easily be compared or aggregated, because some rules have large effects on banks and others have small effects. Therefore, this section focuses on “major rules” issued by banking regulators so as to highlight how those rules that are expected to have the largest effect are applied to small banks. A major rule is a rule that

⁴² Appendix C to 12 C.F.R. §225. The threshold was raised in the 113th Congress from \$500 million to \$1 billion by P.L. 113-250, which was signed into law on December 18, 2014. The Fed issued a final rule on April 9, 2015 implementing this law.

⁴³ For more information, see CRS Report R42744, *U.S. Implementation of the Basel Capital Regulatory Framework*, by Darryl E. Getter.

⁴⁴ Technically, for purposes of reserve requirements, deposits are defined as “net transaction accounts,” and include demand deposits and certain transfer accounts, but exclude deposits in savings accounts and time deposits. Transaction accounts are netted against certain cash due and in collection. For more information, see Federal Reserve System, “Reserve Requirements,” at <http://federalreserve.gov/monetarypolicy/reservereq.htm>.

⁴⁵ 12 C.F.R. §363 and P.L. 107-204, §404. For more information, see FFIEC, *Joint Report to Congress: EGRPRA*, July 31, 2007, p. 30, at <http://egrpra.ffiec.gov/docs/egrpra-joint-report.pdf>.

has resulted in or is likely to result in – (A) an annual effect on the economy of \$100,000,000 or more; (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets.⁴⁶

Using GAO data,⁴⁷ CRS identified 14 major rules that have been issued since 2010 pursuant to the Dodd-Frank Act and the Basel Accords. **Table 2** describes how each of these major rules affects small banks. Of the 14 major rules, 13 have either an exemption or are tailored for small banks. Prudential regulators (OCC, Fed, or FDIC) issued nine of the major rules and the CFPB issued five.

Table 2. Treatment of Small Banks in Recent “Major Rules” Issued by Banking Regulators Pursuant to the Dodd-Frank Act or the Basel Accords

Official Title	RIN	Differential Treatment of Small Banks
<i>Prudential Regulators</i>		
(1) Liquidity Coverage Ratio: Liquidity Risk Measurement Standards	1557-AD74	Does not apply to banks with less than \$50 billion in total assets.
(2) Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio	1557-AD74	Does not apply to banks with less than \$250 billion in total consolidated assets or \$10 billion in total on-balance sheet foreign exposure.
(3) Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (“Volcker Rule”)	7100-AD82	Applies to all banks, but streamlined compliance policies and procedures for banks with less than \$10 billion in assets.
(4) Treatment Of Certain Collateralized Debt Obligations Backed Primarily By Trust Preferred Securities With Regard To Prohibitions And Restrictions On Certain Interests In, And Relationships With, Hedge Funds And Private Equity Funds	1557-AD79	Applies to all banks that hold CDO-TruPs, including small banks.

⁴⁶ 5 U.S.C. §804(2).

⁴⁷ The Congressional Review Act “requires GAO to report to Congress on whether an agency, in promulgating a major rule, has complied with the regulatory process. GAO does not analyze or comment on the substance or quality of rulemaking. GAO’s report must be made to each house of Congress no later than 15 calendar days after a rule’s submission or publication date.” GAO, “Congressional Review Act (CRA) FAQs,” at http://www.gao.gov/legal/congressact/cra_faq.html#3.

Official Title	RIN	Differential Treatment of Small Banks
(5) Regulatory Capital Rules: Regulatory Capital, Implementation Of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach For Risk-Weighted Assets, Market Discipline And Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, And Market Risk Capital Rule	1557-AD46, 3064-AD95 ^a	Does not apply at the holding company level to BHCs with less than \$1 billion in assets. For banks with \$15 billion or less in assets, the preferential capital treatment of trust preferred securities is grandfathered. Banks with less than \$250 billion in total assets or \$10 billion in foreign exposure are allowed an additional year to phase in the rule and are exempted from the rule's supplemental leverage ratio, advanced approaches for risk-weighted assets, and countercyclical capital buffer, and may opt out of the requirement that unrealized gains and losses be included in net income. Applies the "Market Risk rule" to thrifts with trading assets exceeding \$1 billion or 10% of consolidated assets.
(6) Risk-Based Capital Guidelines: Market Risk	1557-AC99	Does not apply to banks with aggregated trading assets and trading liabilities less than \$1 billion or 10% of total assets.
(7) Debit Card Interchange Fees And Routing	7100-AD63	Does not apply to banks that do not issue debit cards. Does not apply to issuers that, together with affiliates, have \$10 billion or less in assets.
(8) Enhanced Prudential Standards For Bank Holding Companies And Foreign Banking Organizations	7100-AD86	Does not apply to banks with less than \$10 billion in assets. Most provisions do not apply to banks with less than \$50 billion in assets.
(9) Supervision And Regulation Assessments For Bank Holding Companies And Savings And Loan Holding Companies With Total Consolidated Assets Of \$50 Billion Or More And Nonbank Financial Companies Supervised By The Federal Reserve	7100-AD95	Does not apply to banks with less than \$50 billion in assets.
<i>Consumer Financial Protection Bureau</i>		
(10) Ability-To-Repay And Qualified Mortgage Standards Under The Truth In Lending Act (Regulation Z)	3170-AA17	Applies to companies, including small banks, that extend mortgage credit but has additional compliance options—and more lenient thresholds—for certain additional legal protections for some small banks. Small is defined as having less than or equal to \$2 billion in assets and originating 500 or fewer mortgages in the previous year. ^c
(11) Electronic Fund Transfers (Regulation E)	3170-AA15	Applies to companies, including small banks, that consistently send more than 100 remittances a year. Entities that send 100 or fewer remittances are not considered remittance transfer providers and are not covered by the rule.
(12) Loan Originator Compensation Requirements Under the Truth In Lending Act (Regulation Z)	3170-AA13	Applies to companies, including small banks, that originate mortgages, with a limited exemption from some requirements for originators that originate 10 or fewer loans in a 12-month period.

Official Title	RIN	Differential Treatment of Small Banks
(13) Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X)	3170-AA14	Applies to companies, including small banks, that service mortgages, but is adjusted for all companies that are deemed small servicers. A small servicer services 5,000 or fewer mortgages loans and only services mortgages that it or an affiliate originates. Small servicers are exempted from those parts of the rule established at the discretion of the CFPB, but must comply with those parts mandated by the Dodd-Frank Act.
(14) Mortgage Servicing Rules Under the Truth In Lending Act (Regulation Z)	3170-AA14	Applies to companies, including small banks, that service mortgages, but small servicers are exempted from certain requirements related to disclosures and periodic statements. A small servicer services 5,000 or fewer mortgages loans and only services mortgages that it or an affiliate originates.

Source: CRS analysis of major rules identified by GAO, “Congressional Review Act Resources,” at <http://www.gao.gov/legal/congressact/congress.html>.

Notes: RIN = “Regulation Identifier Number.” Hyperlink on Subject column leads to GAO description of rule. Hyperlink on RIN number column leads to rule as published in *Federal Register*. In some cases, the primary regulator has the discretion to exclude or include banks that otherwise would not meet the criteria listed above. The use of the term *banks* in this table refers to any type of depository subsidiary or depository holding company unless otherwise noted. For purposes of this table, prudential regulators are OCC, FDIC, and Fed, issuing rules alone or jointly with each other or other regulators. Some rules have multiple RIN numbers, which are not listed.

- CRS has combined two rules issued separately by regulators on separate dates that are substantively the same.
- There is currently a proposed rule to increase the threshold for the Small Bank Holding Company Policy Statement from \$500 million to \$1 billion.
- The CFPB recently issued a proposed rule to increase the threshold from 500 to 2,000 mortgages. See CFPB, “Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z),” 80 *Federal Register* 7769, February 11, 2015.

As can be seen in **Table 2**, recent regulations have not used a consistent qualitative or quantitative measure for determining exemptions or tailoring. Many rules use asset size, but some use number of activities (e.g., #11, the *Electronic Fund Transfers* rule). Even rules aimed at addressing the same policy issue use different thresholds—for example, rules aimed at policy issues posed by large, complex banks vary the exemption level between \$10 billion, \$50 billion, and \$250 billion.

Most of the major rules issued by prudential bank regulators in **Table 2** are not focused on small banks but are geared primarily toward larger banks. This includes one of the major initiatives in the Dodd-Frank Act (Title I)—a new enhanced prudential regime applied only to banks with assets over \$50 billion and non-banks that have been designated as systemically important (implemented through rules #8 and #9 in **Table 2**).⁴⁸ Eight of the nine major rules have some form or tailoring or exemption for small banks. The only rule that does not have an exemption or tailoring—#4, the *Treatment Of Certain Collateralized Debt Obligations Backed Primarily By Trust Preferred Securities*—modified the *Volcker Rule* to make it easier for banks to hold

⁴⁸ For more information, see CRS Report R42150, *Systemically Important or “Too Big to Fail” Financial Institutions*, by Marc Labonte. Regulators also regulated and examined large, complex banks differently before the Dodd-Frank enhanced prudential regime. For example, the Fed has issued a number of supervisory guidances that applied only to Large Complex Banking Organizations since the 1990s.

securities backed by a form of capital frequently issued by small banks.⁴⁹ Six of the eight major rules with either exemptions or tailoring have size threshold exemptions so that those rules will not apply to small banks at all. Of the remaining two rules, the *Volcker Rule* (#3) is tailored to reduce the compliance costs for banks with less than \$10 billion in assets and small banks are subject to some of the *Basel III Regulatory Capital Rule* (#5), exempted from certain parts of the rule, received tailoring for certain provisions, and a delayed phase-in from the entire rule.

The five rules in **Table 2** issued by the CFPB only apply to those entities involved in certain activities. For example, the rules about originating mortgages (#10 and #12) generally apply to lenders who originate mortgages regardless of whether the entity is a bank. (The rules issued by prudential regulators, by contrast, apply to entities based on their charter, not the activities they perform.) Small banks would be exempt from CFPB rules, therefore, if they did not perform the activity covered by the rule. In addition, all five rules have some form of exemption or tailoring for small banks that perform the covered activity, though some of the exemptions and tailoring are rather limited. The two mortgage servicing rules (#13 and #14) have partial exemptions that are not based on the asset size of the bank but on the amount and type of servicing performed by the bank. The *Electronic Fund Transfers* rule (#11), which has to do with remittance transfers, and *Loan Originator Compensation Requirements* rule (#12) also have exemptions that are based on the amount of the activity performed by the bank, rather than asset size. The *Ability-To-Repay* rule (#10) is tailored to provide additional compliance options for small banks, with small defined based on the bank's asset size and the amount of the activity performed.

Table 2 is useful for understanding which major rules apply to small banks, but provides a limited perspective on recent rulemaking because many recent rules do not fit the criteria used in the table. The Dodd-Frank Act and the Basel Accords have resulted in other well-known rules besides those listed in the table that could still impose a regulatory burden on small banks but are not listed because they are not major rules. The table also does not include recent major rules that are not pursuant to the Dodd-Frank Act and the Basel Accords. Nor does the table include rules issued by the Treasury Department or securities and derivatives regulators which, in some cases, may also apply to small banks involved in those activities. **Table 2** is not intended to be an exhaustive list of all financial reform rules.

In addition to what is missing from the table, there are several points to keep in mind when assessing what is included in the table. The major rules listed in the table vary greatly in length, burden, and complexity; just counting up the number of rules that have been issued may be misleading about the likely effect on small banks. This is especially true given that some requirements may be divided into multiple major rules (e.g., the nine major rules issued by the prudential regulators cover four major policy initiatives)⁵⁰ and in other cases, multiple regulatory goals may be combined into a single major rule. Finally, the presence of an exemption or tailoring in a rule does not in and of itself mean that the rule is optimally structured to achieve its regulatory goal while simultaneously minimizing burden. The exemptions or tailoring included in a rule might apply to a relatively minor part of it. For example, although small banks are exempt from some parts of the *Basel III Regulatory Capital Rule* (#5), they are subject to many other parts of the rule that are viewed as significant. Even if an exemption or tailoring is initially structured to minimize burden, it is possible that the market may adapt and the burden could trickle down to small banks (one example is the possibility that the pricing restrictions on debit

⁴⁹ For more information, see CRS Report IF00007, *Trust Preferred Securities (TruPS) (In Focus)*, by Edward V. Murphy.

⁵⁰ Those policy initiatives are Basel III, enhanced prudential regulation for systemically important financial institutions, the Volcker Rule, and debit card interchange fees.

card issuers under \$10 billion in assets from the *Debit Card Interchange Fees And Routing* rule (#7) may spread to small banks due to market forces).⁵¹

Special Consideration in Statute for Small Banks in the Rulemaking Process

Certain statutes require regulators to consider the regulatory burden on small banks when writing rules. For example, when promulgating new rules, 12 U.S.C. Section 4802 requires that “each Federal banking agency [the OCC, Board of Governors of the Federal Reserve System, and the FDIC] shall consider, consistent with the principles of safety and soundness and the public interest—(1) any administrative burdens that such regulations would place on depository institutions, *including small depository institutions* and customers of depository institutions....” (emphasis added). Similarly, 12 U.S.C. Section 5512(b) states that the CFPB shall consider the impact of rules that it prescribes on banks and credit unions with less than \$10 billion in assets. It also allows the CFPB to exempt providers of financial services (such as banks) from its rules based on total assets or the volume of transactions.

The requirement to consider costs and benefits does not necessarily mean the regulators are required to perform a quantitative cost-benefit analysis. Bank regulators are not subject to Executive Order 12866’s requirement that agencies perform cost-benefit analysis, subject to the Office of Information and Regulatory Affairs’s (OIRA’s) review, for “economically significant” rules.

Pursuant to the Regulatory Flexibility Act (RFA; 5 U.S.C. §§601-612),⁵² regulators are required to include in rulemakings an assessment of the rule’s impact on “small entities,” which would include—but is not limited to—small banks. Agencies are only required to make an assessment if they believe that the rule will have a “significant economic impact on a substantial number of small entities” (the terms *significant*, *substantial*, and *small* are not defined in the act). Since 2013, the banking agencies and CFPB have defined a small bank as assets of \$500 million or less for purposes of the RFA, which is a lower threshold for small entities than the definition of small bank used by the FDIC, Fed, or OCC.⁵³ Most rules do not meet this statutory test.⁵⁴ Agencies can comply with the RFA by making a qualitative or quantitative assessment, and may waive this requirement under certain circumstances. If the rule is determined to have a significant economic impact on a substantial number of small entities, the regulator that is issuing the rule is required

to describe, among other things, (1) the reasons why the regulatory action is being considered; (2) the small entities to which the proposed rule will apply and, where feasible, an estimate of their number; (3) the projected reporting, recordkeeping, and other compliance requirements of the proposed rule; and (4) any significant alternatives to the rule that would accomplish the statutory objectives while minimizing the impact on small entities.⁵⁵

⁵¹ See Hester Peirce, *Scrap Regulations that Thin the Ranks of Small Banks*, Mercatus Center, George Mason University, February 23, 2015, at http://mercatus.org/expert_commentary/scrap-regulations-thin-ranks-small-banks-dodd-frank.

⁵² For more information, see CRS Report R41974, *Cost-Benefit and Other Analysis Requirements in the Rulemaking Process*, coordinated by Maeve P. Carey.

⁵³ As described in the section above “What is a Small Bank?”

⁵⁴ See **Table 3** below for information on which major rules pursuant to the Dodd-Frank Act and Basel Accords have a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act (RFA).

⁵⁵ CRS Report R41974, *Cost-Benefit and Other Analysis Requirements in the Rulemaking Process*, coordinated by Maeve P. Carey, notes that “Section 1100G of the Dodd-Frank Act added a requirement to §603 of the RFA that for covered rules, the Consumer Financial Protection Bureau should include of a number of specific items in their impact

The CFPB, but not the other federal banking regulators, is required under the RFA to convene a small business review panel when a rule that it is developing may have a significant economic impact on a substantial number of small entities.⁵⁶ Through the review panel, the CFPB collects advice and recommendations from representatives who would be affected by the proposed rule related to, among other things, “any projected increase in the cost of credit for small entities” that may result from the rule and “any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for small entities.”⁵⁷ The review panel, which includes individuals from the CFPB, Office of Management and Budget (OMB), and the Small Business Administration’s (SBA’s) Chief Counsel for Advocacy, must issue a report of the panel’s findings as part of the rulemaking process.⁵⁸

Bank regulators are also required by the Small Business Regulatory Enforcement Fairness Act (SBREFA; P.L. 104-121) to develop small entity compliance guides for each final rule that the agency determines has a significant economic impact on a substantial number of small entities.⁵⁹ The compliance guides are intended to explain what a small bank must do to comply with the rule. In past years, banking regulators have not consistently fulfilled this requirement. For example, the Office of the Inspector General (OIG) of the Federal Reserve found in July 2013 that the Fed “was not consistent in developing or updating small entity compliance guides in accordance with SBREFA requirements.”⁶⁰ When the OIG report was published, management at the Fed “concurred with [the] recommendations and stated that it will take steps to implement the recommendations.”⁶¹

In addition to considering a rule’s effect on small banks when issuing the rule, regulators also review a rule’s impact after it takes effect. Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPA; P.L. 104-208, 12 U.S.C. §3311), federal banking agencies are required to conduct a review at least every 10 years “to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions.” The act also requires the agencies to seek public comment and submit a report to Congress. The agencies began the latest review process by seeking public comment in June 2014. In this review, the agencies are placing an emphasis on reducing the regulatory burden on community banks.⁶²

analysis, including ‘any projected increase in the cost of credit for small entities.’”

⁵⁶ P.L. 111-203, §1100G.

⁵⁷ 5 U.S.C. §603.

⁵⁸ For more on review panels, see CRS Report RL34355, *The Regulatory Flexibility Act: Implementation Issues and Proposed Reforms*, coordinated by Maeve P. Carey and CFPB, *Fact Sheet: Small Business Review Panel Process*, at http://files.consumerfinance.gov/f/201205_CFPB_public_factsheet-small-business-review-panel-process.pdf.

⁵⁹ See CRS Report RL34355, *The Regulatory Flexibility Act: Implementation Issues and Proposed Reforms*, coordinated by Maeve P. Carey.

⁶⁰ Federal Reserve Board, Office of the Inspector General, Board Should Enhance Compliance with Small Entity Compliance Guide Requirements Contained in the Small Business Regulatory Enforcement Fairness Act of 1996, July 1, 2013, Executive Summary, at http://oig.federalreserve.gov/reports/FRB_SBREFA_compliance_full_Jul2013.pdf.

⁶¹ Federal Reserve Board Office of the Inspector General, Board Should Enhance Compliance with Small Entity Compliance Guide Requirements Contained in the Small Business Regulatory Enforcement Fairness Act of 1996, July 1, 2013, Executive Summary, at http://oig.federalreserve.gov/reports/FRB_SBREFA_compliance_full_Jul2013.pdf.

⁶² OCC, Fed, FDIC, “Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996,” 79 *Federal Register* 32173, June 4, 2014. Regulations under review can be found at FFIEC, “Regulations Under Review,” at <http://egrpra.ffiec.gov/regulations-under-review/regulations-under-review-index.html>. The previous report can be accessed at FFIEC, *Joint Report to Congress: EGRPA*, July 31, 2007, p. 30, at <http://egrpra.ffiec.gov/docs/egrpra-joint-report.pdf>.

Agency Interaction and Outreach With Small Banks

Bank regulators have taken a number of steps which they say make them more responsive to the needs of community banks. In the FDIC's statement of policy on rulemaking, it states that "Particular attention is focused on the impact that a regulation will have on small institutions and whether there are comprehensive or targeted alternatives to accomplish the FDIC's goal which would minimize any burden on small institutions. Typically, when notice and opportunity for comment is involved, comment is sought on these matters."⁶³ Some recent rules have been issued with "Community Bank Guides" to aid community bank compliance.

For recurring or important issues, regulators issue written supervisory guidance to help ensure compliance. At the beginning of supervisory and regulatory letters issued by the Fed, for example, is a statement of applicability that identifies whether the letter is applicable to community banks.⁶⁴ According to one Fed official, "This additional clarity not only allows community bankers to focus their efforts on the supervisory policies that are applicable to their banks but it also helps to reduce the chance that examiners will inadvertently subject community banks to large bank expectations."⁶⁵

The Fed has Community Depository Institution Advisory Councils at each of the 12 regional banks, which "regularly collect input from community depository organizations on a number of topics, including ways to reduce regulatory burden and to improve the efficiency of our supervision."⁶⁶ The CFPB also has small bank advisory councils. In 2009, the FDIC created a Community Bank Advisory Committee composed of community bank executives to guide it on policy issues that affect small banks and the communities they serve.⁶⁷

The banking regulators have improved outreach to the community banking industry with numerous web resources, seminars, and newsletters. For example, the Fed maintains a Community Banking Connections website that provides "guidance, resources, and tools to help community banks."⁶⁸ The FDIC also conducts roundtables, research, and conferences devoted to community banks.⁶⁹ The OCC has published research on ways in which community banks can reduce costs.⁷⁰

Supervision and Enforcement

Regulatory burden can also result from supervision and enforcement actions. This section reviews the various ways that regulators have incorporated differential treatment for small banks into the supervision and enforcement processes.

Separate Supervision of Small Banks Within and Across Agencies

Small and large banks are supervised in different ways, with one of the differences being who does the supervision and how. As mentioned above in the "Who Regulates Banks and What Do Regulators Do?" section, banks are examined for safety and soundness and for consumer

⁶³ FDIC, "FDIC Law, Regulations, Related Acts: 5000 – Statements of Policy," at <https://www.fdic.gov/regulations/laws/rules/5000-400.html>.

⁶⁴ Federal Reserve Board, *Annual Report 2013*, at <http://www.federalreserve.gov/publications/annual-report/2013-supervision-and-regulation.htm#xbox4.easingregulatoryburdenoncommun-99a70003>.

⁶⁵ Federal Reserve System, *Community Banking Connections*, "Board Staff Perspective on Community Bank Supervision: One Size Doesn't Fit All," at <https://www.communitybankingconnections.org/articles/2014/Q2/view-from-washington>.

⁶⁶ U.S. Congress, House Committee on Financial Services, *Testimony of Scott G. Alvarez, General Counsel of Federal Reserve*, 113th Cong., 2nd sess., April 8, 2014, at <http://federalreserve.gov/newsevents/testimony/alvarez20140408a.htm>.

⁶⁷ FDIC, "FDIC Advisory Committee on Community Banking," at <https://www.fdic.gov/communitybanking/>.

⁶⁸ Federal Reserve System, "Community Banking Connections," at <https://www.communitybankingconnections.org/>.

⁶⁹ FDIC, "Community Banking Initiatives," at <https://www.fdic.gov/regulations/resources/cbi/treport.html>.

⁷⁰ OCC, *An Opportunity for Community Banks: Working Together Collaboratively*, January 13, 2015, at <http://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-community-banks-working-collaborately.PDF>.

protection. Large banks have their supervision divided between prudential regulators for safety and soundness and the CFPB for consumer protection, but the two supervisory responsibilities are combined for banks with \$10 billion or less in assets. Some consider it less burdensome to interact with one regulator rather than two, although small banks are still examined separately by the primary regulator for safety and soundness and consumer protection. Likewise, different subsidiaries of the same institution may be regulated by different regulators.

Banks are assigned a prudential regulator based on their charter. Different regulators supervising banks in different ways could lead to disparate levels of regulatory burden. To ensure consistency and to harmonize supervision *across* regulators, the banking regulators coordinate through the Federal Financial Institutions Examination Council (FFIEC). The FFIEC offers bank examiner training programs and has developed a uniform bank rating system that is employed by the prudential regulators. These and other efforts are intended to promote consistency across bank regulators.

Regulatory burden issues occur not just across regulators, but *within* bank regulators. Regulators supervise banks of different sizes. Some are concerned that supervision practices that are intended to apply only to large banks could trickle down to small banks.⁷¹

One way that regulators address these issues is by structuring their internal organization so that different parts of the agency have responsibility for supervising different banks:

- The OCC has a senior deputy comptroller for Midsize/Community Banking Supervision and a senior deputy comptroller for Large Bank Supervision. The OCC also has separate booklets in the *Comptroller's Handbook* that describe the different ways that large banks and community banks are to be examined.⁷²
- A subcommittee of Fed Board members on Smaller Regional and Community Banking was established in 2011 “with a primary goal ... [of] an understanding of the unique characteristics of community and regional banks and ... the potential for excessive burden and adverse effects on lending. Since its establishment, the subcommittee has led a number of initiatives focused on reducing regulatory burden on community banking organizations ... ”⁷³ The Fed has a separate supervisory framework for banks with \$50 billion or more in assets, banks with between \$10 billion and \$50 billion, and banks with less than \$10 billion in assets “to take account of differences in business models, risks, relative regulatory burden, and other salient considerations.”⁷⁴
- The FDIC has a separate Office of Complex Financial Institutions that focuses on large and complex financial institutions; the Division of Risk Management Supervision examines the remaining FDIC-supervised institutions. To give additional emphasis to community banks, each FDIC examiner is “initially

⁷¹ Gov. Tarullo discussed the possibility of “supervisory trickle down” for stress testing. See Gov. Daniel Tarullo, “A Tiered Approach to Regulation and Supervision of Community Banks,” speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

⁷² OCC, *Comptroller's Handbook*,” at <http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/index-comptrollers-handbook.html>.

⁷³ Federal Reserve Board, *Annual Report 2013*, at <http://www.federalreserve.gov/publications/annual-report/2013-supervision-and-regulation.htm#xbox4.easingregulatoryburdenoncommun-99a70003>.

⁷⁴ Gov. Daniel Tarullo, “A Tiered Approach to Regulation and Supervision of Community Banks,” speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

trained as a community bank examiner” before potentially specializing in other areas.⁷⁵

Examinations

On-site examinations, also referred to as visitorial powers, are part of the supervisory process. A regulator’s visitorial powers include

- (i) Examination of a bank; (ii) Inspection of a bank’s books and records; (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) Enforcing compliance with any applicable Federal or state laws concerning those activities, including through investigations that seek to ascertain compliance through production of non-public information by the bank... [with certain limitations].⁷⁶

Regulators examine banks at least once every 12 months, but banks with less than \$500 million in total assets that have high supervisory ratings and meet certain conditions are examined once every 18 months.⁷⁷ Regulators changed the frequency of examinations in 2007 from once every 12 months to once every 18 months pursuant to the Financial Services Regulatory Relief Act (P.L. 109-351).⁷⁸ In contrast, some large and complex banks have examiners conducting full-time monitoring on-site. The bank receives a report of the findings when an examination is completed.

Bank regulators have established multiple processes for a bank to appeal the results of its examination. Regulators typically encourage a bank to attempt to resolve any dispute informally through discussions with the bank examiner.⁷⁹ The Riegle Community Development and Regulatory Improvement Act of 1994 required banking regulators to establish a formal appeals process for supervisory findings, appoint an independent ombudsman, and create safeguards to prevent retaliation against a bank that disputes their examination findings.⁸⁰

Regulators have taken steps to reduce the regulatory burden associated with on-site examinations. The Fed introduced a new examination program in January 2014 that, according to Governor Tarullo, “more explicitly links examination intensity to the individual community bank’s risk profile.... The new program calls for examiners to spend less time on low-risk compliance issues at community banks.”⁸¹ In testimony before the Senate Banking Committee, Governor Tarullo also stated, “Recognizing the burden that the on-site presence of many examiners can place on the day-to-day business of a community bank, we are also working to increase our level of off-site

⁷⁵ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Testimony of Ms. Doreen Eberley, FDIC*, 114th Cong., 1st sess., February 10, 2015.

⁷⁶ 12 C.F.R. §7.4000.

⁷⁷ For example, see Federal Reserve System, *Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of \$10 Billion or Less*, SR 13-21, December 17, 2013, at <http://www.federalreserve.gov/bankinfo/egrlatters/sr1321.htm>.

⁷⁸ See FFIEC, *Joint Report to Congress: EGRPRA*, July 31, 2007, p. 60, at <http://egrpra.ffiec.gov/docs/egrpra-joint-report.pdf>.

⁷⁹ See OCC, *OCC Bulletin 2013-15: Bank Appeals Process*, at <http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-15.html>.

⁸⁰ P.L. 103-325, §309.

⁸¹ Gov. Daniel Tarullo, “A Tiered Approach to Regulation and Supervision of Community Banks,” speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

supervisory activities.... To that end, last year we completed a pilot on conducting parts of the labor-intensive loan review off-site using electronic records from banks.”⁸²

Reporting and Data Collection

Bank supervision is not a one-time event that occurs when the examiner visits the bank, but rather is an ongoing process that includes monitoring data collected from banks. The number of reports that a bank must submit depends on its size and activities. The primary source of data is the quarterly Reports of Condition and Income, or call report, that the bank submits to its regulator.

The FDIC has argued that call reports “provide an early indication that an institution’s risk profile may be changing” and are therefore important parts of the supervision process.⁸³ The call report is structured to lower the burden on small banks relative to larger and more complex banks. The FDIC states that the

Call Report itself is tiered to size and complexity of the filing institution, in that more than one-third of the data items are linked to asset size or activity levels. Based on this tiering alone, community banks never, or rarely, need to fill out a number of pages in the Call Report, not counting the data items and pages that are not applicable to a particular bank based on its business model. For example, a typical \$75 million community bank showed reportable amounts in only 14 percent of the data items in the Call Report and provided data on 40 pages. Even a relatively large community bank, at \$1.3 billion, showed reportable amounts in only 21 percent of data items and provided data on 47 pages.⁸⁴

Bank regulators have also taken other steps to reduce the burden associated with regulatory reporting. Just as banks file call reports, small bank and thrift holding companies must submit the Consolidated Financial Statements for Bank Holding Companies (the FR Y-9 series). The Fed, which oversees holding companies, recently announced that the reporting requirements for the FR Y-9 series will be reduced for those holding companies with less than \$1 billion in total assets that meet certain criteria.⁸⁵

Even though the CFPB is not the primary supervisor for consumer protection of small banks, the CFPB and the prudential bank regulators are required to collaborate on data requests and examinations as a means of reducing regulatory burden. As described in CRS Report R42572, *The Consumer Financial Protection Bureau (CFPB): A Legal Analysis*, by David H. Carpenter,

prudential regulators must provide the CFPB access to all reports, records, and other documents connected to the examination; must allow the CFPB examiners to participate in all aspects of the examination; and generally must take into account any input that the CFPB’s examiner offers regarding the examination. Also, the Bureau may require reports directly from these depositories, although the Bureau will have to rely on existing reports “to the fullest extent possible.”

⁸² U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Testimony of Governor Daniel K. Tarullo, Federal Reserve*, 113th Cong., 2nd sess., September 9, 2014. More information on the pilot program is available at Federal Reserve System, “Federal Reserve Seeks to Conduct More Loan Reviews Off-Site,” at <https://www.communitybankingconnections.org/articles/2014/q2/loan-reviews-off-site>.

⁸³ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Testimony of Ms. Doreen R. Eberley, FDIC*, 113th Cong., 2nd sess., September 16, 2014.

⁸⁴ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Testimony of Ms. Doreen R. Eberley, FDIC*, 113th Cong., 2nd sess., September 16, 2014.

⁸⁵ Federal Reserve, “Small Bank Holding Company Policy Statement,” press release, January 29, 2015, at <http://www.federalreserve.gov/newsevents/press/bcreg/20150129b.htm>.

Enforcement

When an issue is identified during the supervisory process, bank regulators may require a bank to take corrective measures. As with the appeals process for examinations, there are informal and formal approaches. During the examination process, bank examiners may ask the bank to voluntarily agree to take a corrective action to ensure that it complies with a law or regulation. In some cases, regulators take a more formal approach to compel the bank to take a required action, such as through a prompt corrective action directive or cease and desist order, and may impose monetary and other penalties on the bank. Banks may devote resources to legal expertise to understand enforcement actions that apply to others, thus adding to their own regulatory burden. Frequently, banks and regulators reach settlements to avoid legal actions. Some banks have complained that settlements against their competitors can result in additional regulatory burden upon them, because the terms of the settlement become the new industry standard.

Enforcement actions taken against other banks may discourage a bank from performing certain business functions that they may in fact be allowed to perform. Generally, to provide transparency, regulators publicly disclose formal enforcement actions on their website.

Summary of Treatment of Small Banks in Rulemaking, Supervision, and Enforcement

Regulatory burden can be manifested in multiple ways in each stage of the regulatory process—rulemaking, supervision, and enforcement. Small banks are exempt from many rules, especially recent ones, and the regulations that do apply to small banks are often tailored to reduce their regulatory burden. In addition, financial regulators are required to give consideration during the rulemaking process about what effect rules would have on small banks. Supervision and enforcement are also structured to pose less of a burden on small banks than larger banks.

Because of this requisite differential treatment of small and large banks, one could argue that there not is a “one-size-fits-all” approach to bank regulation. Most aspects of the regulation of small banks are designed to impose less of a burden on small banks than larger banks, but that does not necessarily prove whether the existing regulatory structure is unduly burdensome for small banks. Thus, if small banks are facing unduly burdensome regulation, it is either in absolute terms, as a result of numerous rulemakings implementing the Dodd-Frank Act and other recent acts, or because small banks have less capacity for regulatory compliance than large banks (because there is economies to scale to regulatory compliance, for example), and not because small banks face relatively more regulatory burden than large banks. Even though aspects of regulation are different for small and large banks, it is possible that the exemptions and tailoring for small banks may be inefficiently targeted, and small banks might be able to benefit from additional regulatory relief without undermining the goals of protecting consumers, enhancing the safety and soundness of banks, and promoting financial stability.

Rationales Offered for Regulating Small and Large Banks Differently

As discussed in the last section, a safety and soundness focus on minimizing risk to the taxpayer, which was perceived to be independent of size, favored a unitary model of bank regulation. Governor Tarullo highlighted the role of systemic risk in the crisis as a rationale for moving away from the unitary model, described in more detail next. Other possible rationales for moving away from the unitary model follow.

Systemic Risk

Since the recent financial crisis, regulatory emphasis has been placed on mitigating systemic risk—risks posed to financial stability. There are numerous potential sources of systemic risk, including activities undertaken by small banks. Indeed, systemic risk concerns related to bank runs underlie the economic rationale for the creation of the Fed and deposit insurance.

Nevertheless, given the role of large banks in the crisis, policymakers have been particularly focused on the systemic risk posed by large banks and ensuring that they are not “too big to fail” (meaning that policymakers would “bail them out” to prevent their failure because of systemic risk concerns).⁸⁶ The Dodd-Frank Act attempted to address this problem by imposing heightened prudential regulatory standards on the largest banks relative to small and medium-sized banks.

There are several rationales for this approach. First, if a large bank and its creditors believed that policymakers would intervene to prevent its failure, it would face moral hazard, meaning there would be less incentive to monitor the firm’s riskiness. Heightened regulation could safeguard against the tendency for the firm to increase its riskiness in light of moral hazard. Second, heightened regulation would be a way to potentially help “level the playing field” if too big to fail provides large banks with a funding advantage over smaller banks (because the likelihood of a bailout in case of failure is priced into its funding costs.) Third, if the failure of a large firm poses systemic risk and the failure of a small firm does not, then policymakers would want to make it less likely that large firms would fail than small firms. Similarly, if it is less likely that policymakers will impose losses on creditors of large failed banks on systemic risk grounds, then it is more likely that losses will be imposed on taxpayers in the event of a failure. Thus, heightened regulation could make it less likely that large banks will fail and impose losses on taxpayers. Critics of the enhanced prudential regime believe that regulatory capture could exacerbate the moral hazard problem without effectively curbing risk taking.

A common variation on this theme is the argument that small banks did not *cause* the crisis, and therefore should not be *punished* with new regulations. Although it is beyond the scope of this report to determine to what extent small or large banks caused the crisis, hundreds of small banks failed during the financial crisis,⁸⁷ depleting the FDIC’s deposit insurance fund and placing taxpayers at risk. A case can be made that small banks do not need to face regulatory safeguards that are as stringent as large banks because they pose less systemic risk. But systemic risk is only one of the goals of regulation, and a case can also be made that pre-crisis regulations for small banks were not stringent enough to protect the deposit insurance fund. In other words, if there are macroprudential reasons for having relatively less stringent safety and soundness regulation on small banks than large banks, there are also microprudential arguments for having more stringent regulation in absolute terms on small banks than was in place before the crisis.

Economies of Scale to Compliance

Another potential rationale for regulating small banks differently from large banks would be if there are economies of scale to regulatory compliance costs. The costs of compliance include

⁸⁶ Gov. Daniel Tarullo, “A Tiered Approach to Regulation and Supervision of Community Banks,” speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

⁸⁷ An FDIC study found that community banks did not account for a disproportionate share of bank failures between 1975 and 2011, relative to their share of the industry. Because community banks account for more than 90% of organizations (by the FDIC definition, which as noted above is not limited to a size threshold), most bank failures are community banks, however. See FDIC, *FDIC Community Banking Study*, p. 2-10, December 2012, at <https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf>.

investment in software and information systems, manpower, and specialized knowledge (legal expertise, accounting expertise, and so on). In absolute terms, regulatory compliance costs are likely to rise with size, but regulatory compliance might involve fewer resources for large firms than small firms proportional to overall revenues. In particular, as regulatory complexity increases, compliance may become relatively more costly for small firms than large firms.

From a cost-benefit perspective, if regulatory compliance costs are subject to economies of scale, then the balance of costs and benefits of a particular regulation will differ depending on the size of the bank. For the same regulatory proposal, economies of scale could potentially result in costs outweighing benefits for smaller banks but the benefits outweighing costs for larger banks. In these instances, exemptions or simplified regulations could be warranted for small banks on cost-benefit grounds. In other cases, the benefits might be large enough to outweigh costs to small banks even in the presence of economies of scale.

Empirical evidence on whether compliance costs are subject to economies of scale is hampered by the FDIC's finding that banks are unable to disentangle regulatory compliance costs from general operating costs.⁸⁸ A study by the FDIC's inspector general provides some evidence of economies of scale in compliance. It found that exams of banks with less than \$50 million in assets averaged 335 hours, whereas banks with \$500 million-\$1 billion in assets averaged 850 hours in 2011. In other words, exams for larger banks took longer, but the increase in hours was not linear with the increase in assets.⁸⁹ A 2013 CFPB study on the costs associated with certain regulations found some evidence of economies of scale to compliance, but noted that because it used a case study model that focused on just seven banks, it did not draw broad generalizations from its findings.⁹⁰ A survey⁹¹ of members by the Independent Community Banks Association showed mixed evidence of economies of scale in call report compliance. For banks with less than \$500 million in assets, costs were similar regardless of the banks' size, but for banks with more than \$500 million in assets, costs were significantly higher than for banks with less than \$500 million in assets. Because the survey was of members and members are generally small, it did not contain evidence for call report compliance costs for the largest banks, however.

Critical Mass

Another potential reason for exempting small banks from (or tailoring) certain regulations would be if few banks within a class (based on size or some other metric) engage in that activity. In other words, banks within a class would be subject to the regulation only if there were a critical mass of banks for which it was relevant.⁹²

For any given area of regulation, there might not be a critical mass among small banks because of differences in business model from large banks. Or there could be no critical mass because

⁸⁸ See FDIC, *FDIC Community Banking Study*, p. B-2, December 2012, at <https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf>.

⁸⁹ Data are for banks with high CAMELS rating. See FDIC Office of Inspector General, *The FDIC's Examination Process for Small Community Banks*, AUD-12-011, August 2012, at <http://www.fdicog.gov/reports12/12-011AUD.pdf>.

⁹⁰ CFPB, *Understanding the Effects of Certain Deposit Regulations on Financial Institutions' Operations*, November 2013, p. 113, at http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf.

⁹¹ Independent Community Bankers of America, *2014 ICBA Community Bank Call Report Burden Survey*, at <http://icba.org/files/ICBASites/PDFs/2014CallReportSurveyResults.pdf>.

⁹² An alternative way to address this issue would be through activity-based regulation, instead of institution-based regulation with an exemption.

regulation is aimed at policy issues that are perceived to exist primarily at large banks. For example, Tarullo recently highlighted the Volcker Rule (i.e., the prohibition on proprietary trading and sponsoring hedge funds) as a rule applying to all banks, but which he argued that the activities of small banks were unlikely to pose the problems that the Volcker Rule was intended to address.⁹³

This issue could also be considered from a cost-benefit perspective—while regulators might forgo some benefits by exempting those institutions from within a class that are active in the area of concern, those benefits might not outweigh the costs that would be imposed on the nonactive institutions within the class. For example, the regulation of activities might have nontrivial compliance costs for nonparticipants (e.g., the costs of demonstrating to regulators that a bank is complying with rules in an area where that bank is not active). Moreover, if few in the class have a risk exposure in a given area, there is less likelihood that that risk would pose systemic concerns. Applying exemptions on the grounds of lack of critical mass would arguably be best done on a case-by case basis. Within a cost-benefit framework, there would still likely be cases where the benefits of regulating a few small banks that participated in an activity outweighed the costs of regulating the rest that did not.

Creating Advantages for Small Banks

Some policymakers would like to tailor regulation to favor small banks because they believe small banks provide a unique public benefit. Generally, some argue for reducing the regulatory burden on small banks on the grounds that they provide greater access to credit or offer credit at lower prices than large banks. (Empirical evidence on this is mixed—for example, data indicate that small banks make relatively fewer residential mortgages and credit card loans than large banks but make relatively more small business loans.)⁹⁴ Theoretically, market forces should ensure that the lowest price and highest supply of credit that the market will bear will prevail if markets are perfectly competitive; if small banks are offering broader access to credit or lower prices, they will succeed in drawing business without preferential policy. In this framework, creating differences in regulatory burden based on size would distort the efficient allocation of credit. If markets are not perfectly competitive (because large banks might have some market power, for example) or the regulatory burden already differs by size, then those results might not hold. For example, the costs of regulatory compliance (notably, the large amount of capital required to start a bank) may impose a barrier to entry that favors incumbents and reduces competition.

Arguments about the importance of small banks tend to emphasize niches they fill where, it is claimed, larger banks would be ill equipped to replace them, such as in rural and underserved areas. Data to support these arguments include the fact that community banks held 71% of total deposits in rural counties in 2011 (compared with 19% of overall deposits).⁹⁵ Some argue that

⁹³ Gov. Daniel Tarullo, “A Tiered Approach to Regulation and Supervision of Community Banks,” speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

⁹⁴ See U.S. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings*, GAO-12-881, September 2012, pp.14-19, at <http://www.gao.gov/assets/650/648210.pdf>. GAO defines small banks as banks having assets of \$10 billion or less. One study found that until the mid-1990s local banks made relatively more small business loans in underserved areas, but in the late 1990s the trend reversed and they made relatively fewer. See Robert DeYoung, W. Scott Frame, and Dennis Glennon, et al., *Commercial Lending Distance and Historically Underserved Areas*, Federal Reserve Bank of Atlanta, July 2007, at https://www.frbatlanta.org/research/publications/wp/2007/07_11.aspx.

⁹⁵ See FDIC, *FDIC Community Banking Study*, p. 3-6, December 2012, at <https://www.fdic.gov/regulations/resources/>

rules must be more flexible or include exemptions for small banks to be able to extend adequate credit to rural and underserved areas. Examples of this principle can be found in existing regulation—for example, lenders in rural areas have additional compliance options for the Ability-to-Repay rule that are not available to some other banks.⁹⁶ Similarly, it is argued that small banks are better situated to engage in types of transactions that depend on “relationship banking” (i.e., personalized knowledge of risks). For example, data indicate that small banks make relatively more agricultural loans than large banks.⁹⁷ It is argued that rigid regulations with standardized criteria are not well suited for the relationship banking model.⁹⁸ Alternatively, if the policy goal is to help rural or underserved communities, it could arguably be more efficient to target those populations directly, rather than providing regulatory relief to small banks regardless of how much credit they provide to those populations.

Some may want to protect community banks out of a preference for their traditional business model. Community banks are also more likely to engage in portfolio lending, as opposed to the originate-to-distribute (securitization) model; some policymakers prefer the former, given the role the latter played in the crisis.⁹⁹

Ultimately, evaluating arguments about the desirability of reducing their regulatory burden in order to promote small banks requires subjective value judgments about the relative desirability of competing policy goals. While some want to reduce the burden on small banks for the reasons cited above, others argue that reducing the burden on banks by exempting them from certain rules could lead to regulatory arbitrage—moving activities to less regulated entities in order to avoid regulation. Regulatory arbitrage could result in disparate treatment for consumers, for example, as consumers might only have protections when they operate at some institutions but not at others.

Empirical Evidence of the Regulatory Burden on Small Banks

This report has explained how small and large banks are regulated and how that regulation can translate into regulatory burden. Quantifying the magnitude of regulatory burden for banks has been a challenge for researchers, including the FDIC, GAO, and CFPB.¹⁰⁰ The FDIC’s “Community Banking Study” found,

[cbi/report/cbi-full.pdf](#).

⁹⁶ For more information, see CRS Report R43081, *The Ability-to-Repay Rule: Possible Effects of the Qualified Mortgage Definition on Credit Availability and Other Selected Issues*, by Sean M. Hoskins.

⁹⁷ Tanya D. Marsh, “Reforming the Regulation of Community Banks After Dodd-Frank,” *Indiana Law Journal*, vol. 90, no. 179, p. 19.

⁹⁸ See Conference of State Bank Supervisors, *An Incremental Approach to Financial Regulation: Right-Sized Regulations for Community Banks*, December 2013, at <http://www.csbs.org/legislative/testimony/Documents/An%20Incremental%20Approach%20to%20Financial%20Regulation.pdf>.

⁹⁹ In portfolio lending, a bank holds the loan that it originated on its own books, so it retains the risks associated with the loan. By retaining the risk, some argue, the bank has greater incentive to make high-quality loans. See Conference of State Bank Supervisors, *An Incremental Approach to Financial Regulation: Right-Sized Regulations for Community Banks*, December 2013, at <http://www.csbs.org/legislative/testimony/Documents/An%20Incremental%20Approach%20to%20Financial%20Regulation.pdf>.

¹⁰⁰ Other, nongovernmental, sources have also analyzed the regulatory burden on small banks. For example, see Marshall Lux and Robert Greene, *The State and Fate of Community Banking*, Harvard Kennedy School, 2015, at <http://www.hks.harvard.edu/centers/mrcbg/publications/awp/awp37>; KPMG, *2014 Banking Industry Outlook Survey*, at http://www.kpmginfo.com/industryoutlooksurveys/2014/pdfs/KPMGBankingIndustrySurvey_072414.pdf; Hester

In an attempt to quantify the cost of regulatory compliance at their institution, interview participants were asked whether they tracked regulatory compliance costs within their internal cost structure. All the interview participants indicated that they did not actively track the various costs associated with regulatory compliance, because it is too time-consuming, costly, and is so interwoven into their operations that it would be difficult to break out these specific costs.¹⁰¹

In September 2012, GAO reported to Congress that “[i]ndustry officials told us that it is difficult to know for sure which provisions [of the Dodd-Frank Act] will impact community banks and credit unions, because the outcome largely depends on how agencies implement certain provisions through their rules, and many of the rules implementing the act have not been finalized.”¹⁰² Since then, GAO has issued other reports on the Dodd-Frank Act rulemaking but has not attempted to quantify the regulatory burden on small banks.

A November 2013 CFPB case study of the regulatory burden in the area of consumer protection looked at compliance costs at seven banks of varying size for four regulations. It found that compliance costs for certain regulations as a percentage of retail operating expense at the two banks in the study with less than \$1 billion in assets were 3.9% and 5.6% of retail deposit operating expense, respectively—more than double the percentage for the banks with more than \$1 billion in assets.¹⁰³ It costs the smaller banks relatively more to comply than the larger banks. As the CFPB notes, “Seven case studies do not, however, justify broad generalizations—especially about scale effects...”¹⁰⁴ The CFPB report also describes the challenges it faced in analyzing regulatory burden, including that banks “generally do not track their full costs of compliance, and the relevant information is often scattered across several departments and many employees.”¹⁰⁵

One reason that only incomplete information on regulatory burden exists is because no statute requires regulators to make quantitative estimates for all rules that they issue. As discussed in the “Special Consideration in Statute for Small Banks in the Rulemaking Process” section above, there are three types of statutory requirements that provide some information on regulatory burden:

- Pursuant to 12 U.S.C. §4802, banking regulators are generally required to “consider costs” and benefits but do not necessarily have to perform a quantitative cost-benefit analysis. **Table 3** summarizes how bank regulators reported costs and benefits for the 14 major rules pursuant to the Dodd-Frank Act. It shows that regulators did not quantify overall costs or benefits for any of these rules. The prudential regulators quantified some costs (while qualitatively

Peirce, Ian Robinson, and Thomas Stratmann, *How Are Small Banks Faring under Dodd-Frank?*, Mercatus Center, February 27, 2014, at <http://mercatus.org/publication/how-are-small-banks-faring-under-dodd-frank>; Sam Batkins, *Dodd-Frank Fails at Measuring Costs and Benefits*, American Action Forum, February 19, 2015, at <http://americanactionforum.org/insights/dodd-frank-fails-at-measuring-costs-and-benefits>.

¹⁰¹ FDIC, *FDIC Community Banking Study*, p. B-2, December 2012, at <https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf>.

¹⁰² GAO, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings*, GAO-12-881, September 2012, pp.14-19, at <http://www.gao.gov/assets/650/648210.pdf>.

¹⁰³ CFPB, *Understanding the Effects of Certain Deposit Regulations on Financial Institutions’ Operations*, November 2013, p. 103, at http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf.

¹⁰⁴ CFPB, *Understanding the Effects of Certain Deposit Regulations on Financial Institutions’ Operations*, November 2013, p. 113, at http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf.

¹⁰⁵ CFPB, *Understanding the Effects of Certain Deposit Regulations on Financial Institutions’ Operations*, November 2013, p. 6, at http://files.consumerfinance.gov/f/201311_cfpb_report_findings-relative-costs.pdf.

discussing benefits) for two rules, qualitatively discussed costs and benefits for three rules, and CRS could not locate any cost-benefit analysis for the other four rules. The CFPB quantified some costs (while qualitatively discussing benefits) for two rules and qualitatively discussed costs and benefits for three rules.¹⁰⁶ Generally speaking, costs and benefits for small banks might be qualitatively discussed in these analyses, but quantitative estimates did not break out effects on small banks.

- The Regulatory Flexibility Act requires regulators to perform an assessment only for rules that are determined to have a significant economic impact on a substantial number of small entities. In their RFA analysis, the regulators use a lower threshold for small entities (currently, \$500 million or less in assets) than the definition of small bank used by the FDIC, Fed, or OCC. **Table 3** summarizes whether the regulators found a significant economic impact on a substantial number of small entities for the 14 major rules pursuant to the Dodd-Frank Act. The prudential regulators found no significant impact on small entities for seven rules and could not determine whether there was a significant impact for one rule. They found that one rule, the Basel III Regulatory Capital rule, may have a significant impact, estimating that 146 banks with less than \$500 million in assets (out of 5,638 overall) faced a capital shortfall of \$620 million, certain compliance costs of \$43,000 per institution, and lost tax benefits totaling \$3.4 million per year under the rule when fully phased in.¹⁰⁷ The CFPB could not rule out that any of the five rules it issued would not have a significant impact on small entities. In one case, it did not know how many small entities would be affected, and in four other cases, it estimated that more than 3,700 banks or thrifts (as well as credit unions and non-banks) with less than \$175 million in assets participated in the activity addressed by the rule, although it provided no quantitative estimate of the costs to those firms or how many would be covered by the exemptions or tailoring provided in the rules.
- The Paperwork Reduction Act (P.L. 104-13) requires regulators to estimate the hours that banks spend complying with its requests for information. Agencies must report this information to the OMB's Office of Information and Regulatory Affairs (OIRA), which posts it on its website.¹⁰⁸ Although the hours spent complying with regulators' requests for information is just one component of regulatory burden, agencies do not break the data out to distinguish between hours spent by small and large banks, further complicating the effort to estimate the magnitude of regulatory burden for small banks.

¹⁰⁶ Similarly, for all major rules, OMB reports by agency whether the agency provided "some information on benefits or costs." Between 2010 and 2013, it found that the banking regulators issued 17 major rules overall, of which the agencies reported "some information on benefits or costs" for 3 of those rules. In addition, the CFPB issued 6 major rules and provided some information on benefits or costs for all of them. See Table C-1 and C-2 of http://www.whitehouse.gov/sites/default/files/omb/inforeg/2014_cb/draft_2014_cost_benefit_report-updated.pdf.

¹⁰⁷ OCC and Federal Reserve System, "Regulatory Capital Rules," 78 *Federal Register* 62149, October 11, 2013 and FDIC, "Regulatory Capital Rules," 78 *Federal Register* 55340, September 10, 2013.

¹⁰⁸ Records can be accessed at <http://www.reginfo.gov/public/do/PRAsearch>.

Table 3. Summary of Cost-Benefit and Regulatory Flexibility Act Analyses for Recent “Major Rules” Issued by Bank Regulators Pursuant to the Dodd-Frank Act

Official Title	RIN	C-B Analysis Performed?	Was There a “Significant Economic Impact on Small Entities”?
<i>Prudential Regulators</i>			
Liquidity Coverage Ratio: Liquidity Risk Measurement Standards	1557-AD74	OCC quantified costs, provided qualitative benefits (FDIC and Fed did not perform)	no
Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio	1557-AD74	OCC quantified costs, provided qualitative benefits (FDIC and Fed did not perform)	no
Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (“Volcker Rule”)	7100-AD82	none	no
Treatment Of Certain Collateralized Debt Obligations Backed Primarily By Trust Preferred Securities With Regard To Prohibitions And Restrictions On Certain Interests In, And Relationships With, Hedge Funds And Private Equity Funds	1557-AD79	none	no
Regulatory Capital Rules: Regulatory Capital, Implementation Of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach For Risk-Weighted Assets, Market Discipline And Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, And Market Risk Capital Rule	1557-AD46, 3064-AD95 ^a	qualitative discussion by agencies; quantitative global study of costs and benefits by Financial Stability Board before the U.S. rule was proposed	maybe; 146 banks with less than \$500 million in assets (out of 5,638 overall) faced a capital shortfall of \$620 million, lost tax benefits totaling \$3.4 million per year, and certain compliance costs of \$43,000 per institution under the rule when fully phased in
Risk-Based Capital Guidelines: Market Risk	1557-AC99	qualitative discussion	no
Debit Card Interchange Fees And Routing	7100-AD63	qualitative discussion (Fed concluded it does not know if costs outweigh benefits)	despite exemption, do not know
Enhanced Prudential Standards For Bank Holding Companies And Foreign Banking Organizations	7100-AD86	none	no

Official Title	RIN	C-B Analysis Performed?	Was There a “Significant Economic Impact on Small Entities”?
Supervision And Regulation Assessments For Bank Holding Companies And Savings And Loan Holding Companies With Total Consolidated Assets Of \$50 Billion Or More And Nonbank Financial Companies Supervised By The Federal Reserve	7100-AD95	none	no
<i>Consumer Financial Protection Bureau</i>			
Ability-To-Repay And Qualified Mortgage Standards Under The Truth In Lending Act (Regulation Z)	3170-AA17	some costs quantified, other costs and benefits discussed qualitatively	cannot rule it out, rule affects 3,839 banks and thrifts with <\$175m in assets; no estimate of costs
Electronic Fund Transfers (Regulation E)	3170-AA15	qualitative discussion of costs and benefits	cannot rule it out, do not know how many or cost
Loan Originator Compensation Requirements Under the Truth In Lending Act (Regulation Z)	3170-AA13	qualitative discussion of costs and benefits	cannot rule it out, rule affects 3,839 small banks and thrifts with <\$175m in assets; no estimate of costs
Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X)	3170-AA14	qualitative discussion of costs and benefits	cannot rule it out, rule affects 3,714 small banks and thrifts with <\$175m in assets; no cost estimate
Mortgage Servicing Rules Under the Truth In Lending Act (Regulation Z)	3170-AA14	some costs quantified, other costs and benefits discussed qualitatively	cannot rule it out, rule affects 3,714 small banks and thrifts with <\$175m in assets; no estimate of costs

Source: CRS analysis of rules and supporting documents, GAO reports under the Congressional Review Act

Note: RIN = “Regulation Identifier Number.”

- a. CRS has combined two rules issued separately by regulators on separate dates that are substantively the same.

In summary, all three of these requirements result in the regulators estimating only partial—if any—costs associated with regulation. Estimates are made before rules are implemented and are generally not revisited after the fact to test their accuracy. In any case, all of these statutory requirements apply only to the issuance of new rules, which are just one subset of the sources of overall regulatory burden; there are no statutory requirements for regulators to estimate the costs associated with regulation (rulemaking, supervision, and enforcement) as a whole. Because estimates are typically made for individual rules in isolation, there is little understanding of what happens to overall burden when rules are aggregated.

Although quantitative assessments may help policymakers understand the magnitude of the regulatory burden associated with new and existing regulations, there are reasonable arguments for why they should not be performed. In their qualitative assessments, regulators often detail the multiple unknowns that would make a quantitative estimate subject to considerable uncertainty. Regulators issue hundreds of new rules annually, some of which involve relatively minor changes; quantitative requirements could significantly increase the resources required for rulemaking or potentially slow down the rulemaking process. Regulators have noted the difficulty of performing accurate cost-benefit assessments for some complex rules. For example, a Fed official testified,

the challenges (sic) is that it's easy to measure the cost because they fall to specific institutions. It's much harder to measure the benefits because they really accrue to a very broad population. Things like safety and soundness of the banking system or confidence in the payment system. Analyses that include a high degree of uncertainty could potentially be misleading and do more harm than good.¹⁰⁹

Furthermore, the requests for data and the additional information that could be necessary to perform more detailed studies could themselves result in more regulatory burden.

Regulators do not regularly report data on the burden stemming from supervision. Sometimes they produce one-time studies, however. In response to a congressional request, bank regulators' inspectors general conducted studies on the regulatory burden to small banks stemming from compliance with supervisory exams. From 2007 to 2011, OCC community bank exams typically took 120 days or less (as they are intended to), but sometimes took up to a year, and occasionally took over a year.¹¹⁰ The length of exams was slightly longer from 2008 to 2010, when the most banks were failing. In 2011, FDIC community bank risk-management exams varied in length from an average of 335 hours to 1,820 hours based on the size of the bank and its supervisory rating. From 2007 to 2011, exams of banks with poor supervisory ratings became shorter over time and banks with good supervisory ratings took longer over time. In addition, the FDIC conducts thousands of compliance and a few CRA exams annually. In 2011, the FDIC spent an average of 24 days to 57 days on-site for risk management exams, based on supervisory rating.¹¹¹ Fed exams (not including state-led exams, which took longer), averaged 63 days to 79 days between 2007 and 2011, peaking in 2009.¹¹² Although costs cannot be derived directly from hours spent on exams, this data may nevertheless give some indication of regulatory burden caused by meeting with examination staff and uncertainty created while waiting for exam results.

By statute (12 U.S.C. §4806), banks may appeal exam results to the agency Ombudsman. The frequency of appeals might give some indication of bank displeasure with the examination process. The IGs report that banks only formally appealed 22 OCC exam results (informally appealed 24 more), 23 FDIC exams (informally appealed 18 more), and 12 Fed exams (no informal appeal data) out of the thousands of exams performed between 2007 and 2011. However, banks might not appeal an exam result they thought was unfair if they thought their appeal had no chance of succeeding. As noted above, many disputes are resolved through the supervisory process, before an exam is completed.

There is no official data on the regulatory burden associated with call reports. The Independent Community Bankers of America (ICBA), a trade association representing community banks, conducted a survey, however, which found that “[a]lmost three quarters of respondents stated that the number of hours required to complete the call report had increased over the last ten years. Over one third of respondents indicated a significant increase in hours over this period. Well over three quarters of respondents noted increased costs in call report preparation with almost one third

¹⁰⁹ Deputy Director Maryann Hunter, Federal Reserve, testimony before the U.S. Senate, Committee on Banking, Housing, And Urban Affairs, February 10, 2015, transcript from <http://www.cq.com/doc/congressionaltranscripts-4623253?4>.

¹¹⁰ Department of the Treasury, Office of Inspector General, *Safety and Soundness: Review of OCC Community Bank Examination and Appeals Processes*, August 31, 2012, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG12070.pdf>.

¹¹¹ See FDIC, Office of Inspector General, *The FDIC's Examination Process for Small Community Banks*, AUD-12-011, p. 8, August 2012, at <http://www.fdicogig.gov/reports12/12-011AUD.pdf>.

¹¹² Federal Reserve System, Office of Inspector General, *Audit of the Small Community Bank Examination Process*, p. 18, August 2012, at http://oig.federalreserve.gov/reports/Audit_SCB_Exam_Process_August2012.pdf.

noting that costs increased significantly.”¹¹³ As noted above, regulators argue that the call reports are already tailored to reduce the burden on small banks.

Studies have attempted to estimate the regulatory burden of specific policies,¹¹⁴ but there is a dearth of empirical evidence on the overall regulatory burden posed by bank regulation. Because there are no official quantitative estimates of—or data sources for—the absolute regulatory burden on the banking system as a whole, it is impossible to provide empirical evidence that gives an overall answer to the two the questions pertinent to this report: (1) what is the absolute regulatory burden on small banks and how has it changed? and (2) what is the burden on small banks relative to large banks and how has it changed?

Options to Account for Size in Alternative Regulatory Models

If Governor Tarullo is correct that recent rulemaking has resulted in a *de facto* shift away from the unitary model, Congress may choose to consider what model would best achieve its policy priorities. Rather than discuss the many provisions of bank regulation or supervisory practices that could be modified to provide regulatory relief within the existing system, this section focuses on the different ways that the regulatory system could be structured to account for size, presenting the pros and cons of each approach. The spectrum of options ranges from regulating banks in the same way regardless of size to a separate regulatory regime for small banks and large banks, with various approaches in between.

Maintain Status Quo (Ad Hoc Exemptions)

Absent change to the status quo, all banks will continue to be assigned a primary regulator by charter and subject to the same regulations except in cases where exemptions or tailoring based on size has been provided by statute or regulator discretion. In addition, some current exemptions that are not based on size might still tend to disproportionately benefit small banks, such as exemptions for banks operating in rural or underserved areas. As new laws and regulations are adopted, policymakers will decide on a case-by-case basis whether the law or rulemaking will have a size-based exemption or tailoring, and if so, what size threshold to use. New legislation can also be used to retroactively add or amend size exemptions in existing statute.¹¹⁵

The advantage of this ad hoc approach is that exemptions can theoretically be individually tailored to the optimum size for each policy issue, given that the optimal size is likely to vary by issue based on the regulation’s purpose. The disadvantage is a lack of coherence and consistency in the overall regulatory structure, which is likely to add to the overall complexity and burden of regulation. Some might argue that ad hoc exemption levels are not set at optimal levels based on some objective standard in practice, but are instead arbitrarily chosen based on fluid political

¹¹³ Independent Community Bankers of America (ICBA), *2014 ICBA Community Bank Call Report Burden Survey*, at <http://www.icba.org/files/ICBASites/PDFs/2014CallReportSurveyResults.pdf>.

¹¹⁴ For example, the Financial Stability Board and Basel Committee provided macroeconomic estimates of the effects of implementing Basel III capital standards. See Macroeconomic Assessment Group, *Assessing the Macroeconomic Impact of the Transition to Stronger Capital and Liquidity Requirements*, Dec. 2010, <http://www.bis.org/publ/othp12.pdf>.

¹¹⁵ H.R. 1599, the Community Institution Mortgage Relief Act of 2015, for example, would (among other things) direct the CFPB to raise its small servicer exemption in a mortgage servicing rule to include servicers that service 20,000 or fewer mortgage loans from the current 5,000 loan threshold.

dynamics. Maintaining the status quo model might also make it more difficult to address existing regulations where policymakers believe an exemption should be added, since regulations would have to be altered individually, and there is no mechanism in place to revisit them expeditiously.

Institute Consistent Exemption Size

A variation on the status quo would be to move to a consistent exemption size for all regulations with exemptions set by statute or the regulators. Such a system could give regulators discretion as to when to apply exemptions or include standardized criteria in statute for when exemptions should be applied.¹¹⁶ The advantages and disadvantages of this option—more consistency and predictability, less flexibility—would be the inverse of the advantages and disadvantages discussed in the status quo section. Whether it reduced the regulatory burden on small banks compared to the status quo would depend on where the exemption was set and how frequently regulators applied it. Were policymakers to adopt a standard exemption, they could also consider whether there should be a process for retroactively applying it to existing regulations.

Were policymakers to move to a single exemption level, the question would be whether the exemption should be set relatively high, so that regulations with exemptions only applied to very large, complex banks, who tend to be active internationally and have non-bank subsidiaries with substantial operations, or whether exemptions should be set relatively low, so that it applied only to relatively small banks that tended to have simple business models.¹¹⁷ In other words, the question would be how many – if any – of the banks in the middle of the spectrum (often referred to in policy debates as “regional banks”) should be exempt.

A variation on a standard exemption level would be to have regulators set varying exemption levels based on some standard criteria or standardized process that has been formulated *ex ante*. For example, regulators could be required to set the exemption threshold so that the benefits of the regulation outweighed the costs. This could result in more appropriately tailored exemption levels than a standard exemption, but would entail more time and resources on the part of regulators. It would arguably not result in a simpler regulatory system than the status quo.

A unitary model with a consistent exemption size would not address concerns for and against the next two options regarding regulatory specialization or a level playing field.

A System with Size-Based Charters

As discussed above, different bank charters exist in statute, but differences in operations and regulations between charters have blurred over time. Eligibility for charters is not based on size; although thrifts and credit unions are smaller than banks on average, there are also large thrifts and credit unions. One policy option would be to replace the current system with charters and regulators based on a size threshold. For example, there could be a “community bank” charter and a “large complex organization” charter, and a separate regulator to administer each charter. Modifying the basis of charters might naturally lend itself to a broader reevaluation of the optimum number of charters and regulators—a reduction in which could in itself be conducive to reducing regulatory burden and complexity.

¹¹⁶ This model would not apply a standard exemption to all regulations, or else all banks subject to the exemption would be completely unregulated.

¹¹⁷ In an interview with *American Banker*, Sheila Bair, former chairman of the FDIC, suggested a \$10 billion threshold for broad exemptions and tailoring. See Rob Blackwell, “The Easy Legislative Fix that Could Save Community Banks,” *American Banker*, February 23, 2015.

The potential advantage of this system would be that regulations could be more attuned to differences in large and small banks' business models. Regulators often tailor regulations now, but a separate charter would be the simplest way to guarantee it. With a division of labor, each regulator could be more specialized, knowledgeable, and sensitive to the unique issues facing the banks that it regulated. Taken to the extreme, two fundamentally separate and distinct regulatory architectures could emerge, as has happened with credit unions and banks. This might allow for simpler and less burdensome regulation for small banks (depending on how their regulator behaved), but two systems would arguably be more complex overall than one.

The potential advantage of this system could turn out to be a weakness, however, because it could make the system more susceptible to "regulatory capture," even if Congress chose to put safeguards in place to prevent it. Regulatory capture is the concept that regulators work in the interests of the entities that they regulate instead of the public interest. A size-based charter could make it more likely that the small bank regulator worked in the interests of the small banks and the large bank regulator worked in the interest of the large banks. It would also follow that it could be more likely that the regulators and the regulations that they issued would be in conflict with one another, perhaps creating opportunities for regulatory arbitrage.

Some might see parallels between such a proposal and perceived regulatory capture problems with the former Office of Thrift Supervision (OTS). OTS regulated thrifts, which began as mostly small institutions with a statutorily limited business model. Over time, regulatory differences between banks and thrifts eroded, and it was claimed that some firms chose a thrift charter (called charter shopping) because OTS was the least onerous federal regulator.¹¹⁸ The Dodd-Frank Act abolished the OTS (but kept the thrift charter) out of the widely held belief that the OTS had been captured by thrifts and was insufficiently monitoring their riskiness.¹¹⁹ In contrast, it might be argued that problems with OTS were not relevant to a size-based charter. One problem with the OTS was that it was believed to lack the expertise or perhaps the authority to adequately regulate a few very large, complex organizations, such as Washington Mutual, AIG, and Lehman Brothers, that in some cases had very limited depository activities. Basing the charter on a size threshold might avoid problems such as charter shopping and lack of regulatory expertise, if the threshold was applied at the holding company level rather than the depository subsidiary level.

"Level Playing Field" (Unitary Model)

The opposite end of the spectrum from separate chartering would be a "level playing field" or a "true unitary" approach in which regulations were not tailored to account for size or other differences between banks. Moving to a true unitary approach might naturally lend itself to reducing the number of charters and regulators, which could in itself be conducive to reducing regulatory burden and complexity. The advantage of this approach would be to minimize opportunities for regulatory arbitrage—the possibility of activities migrating to banks where the

¹¹⁸ For a review of the erosion of differences between banks and thrifts, see Dain Donelson and David Zaring, "Requiem for a Regulator," *North Carolina Law Review*, 2011, vol. 89, p. 1777, at <http://www.nclawreview.org/documents/89/5/zaring.pdf>; "Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors," *Review of Banking and Financial Law*, Issue I, Fall 2010, Ch. IX, <http://www.bu.edu/rbfl/files/2013/09/TransferOfPowers.pdf>.

¹¹⁹ The Office of Thrift Supervision's (OTS's) performance during the financial crisis is reviewed in U.S. Congress, Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations, *Wall Street and the Financial Crisis, Majority and Minority Staff Report*, 112th Cong., 1st sess., April 13, 2011, chap. 4. For an additional perspective, see Dain Donelson and David Zaring, "Requiem for a Regulator," *North Carolina Law Review*, 2011, vol. 89, p. 1777, at <http://www.nclawreview.org/documents/89/5/zaring.pdf>; "Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors," *Review of Banking and Financial Law*, Issue I, Fall 2010, Ch. IX, <http://www.bu.edu/rbfl/files/2013/09/TransferOfPowers.pdf>.

activities are exempt from regulation. This could increase the overall efficiency of financial intermediation and credit allocation. The disadvantages of this approach would be that regulations would be less targeted although banks are diverse, so that some regulations could impose regulatory costs on banks that are not relevant to them.

In cases where small banks were losing exemptions from regulations, it would make them worse off. But in some cases, a level playing field could make small banks better off. For example, some critics of Dodd-Frank's enhanced prudential regulatory regime claim that it is beneficial to large banks because of regulatory capture and that it formalizes their too big to fail status. If this were true, ending the enhanced prudential regulatory regime for large banks would level the playing field to the benefit of small banks.

Whether such an approach resulted in more or less regulatory burden for small banks depends on how current policies with size-based exemptions were reworked. A level playing field approach might be supported whether one is in favor of more or less regulation for banks overall. Whether the focus is on reducing regulatory burden or mitigating risk through enhanced regulation, a case could be made that either goal is better achieved and more likely to succeed if implemented consistently for all banks, regardless of size.

Observations

This report analyzed the relative burden of small versus large banks and finds that small banks have received accommodations in recent major rules and through various supervisory arrangements and outreach. Regulatory burden has increased for small banks in absolute terms since the recent financial crisis, but arguably not in relative terms compared with larger banks. For example, 13 of the 14 "major" rules issued by banking regulators pursuant to the Dodd-Frank Act either include an exemption for small banks or are tailored to reduce the cost for small banks to comply. The remaining rule provided regulatory relief for securities backed by a type of capital frequently issued by small banks.

Recent increases in regulatory burden on an absolute but not relative basis may affect the ability of small banks to compete with non-banks, but should not negatively affect their ability to compete with large banks.¹²⁰ This report did not analyze whether the absolute burden is too great because that depends on policymakers' judgments about balancing financial stability, credit availability, consumer protection, and other objectives.

An important distinction drawn by this report is between the concept of *regulatory burden* and the phrase *unduly burdensome*. Whereas regulatory burden is about the costs associated with a regulation, unduly burdensome refers to the balance between the benefits and costs of a regulation. For example, some would consider a regulation to be unduly burdensome if costs are in excess of benefits or if the same benefits could be achieved at a lower cost. But the mere presence of regulatory burden does not mean that a regulation is unduly burdensome.

Overestimating regulatory burden can lead to policies that would repeal or change regulations that may have positive net benefits for consumers, banks, and the broader economy. Underestimating regulatory burden, however, could result in further consolidation in the banking industry, the migration of activity outside the banking system to the shadow banking system, and reduced access and higher cost of credit for rural and underserved areas and small businesses that are customers of small banks. Accurately assessing regulatory burden and determining whether the burden rises to the level of being unduly burdensome, therefore, is important for policymakers

¹²⁰ Assuming economies of scale to compliance effects do not dominate.

to make informed judgments. Quantifying the magnitude of regulatory burden has been a challenge for researchers, however, because banks do not track their compliance costs and regulators do not typically provide estimates of the costs of new rules.

Much of the discussion about unduly burdensome regulation has focused on banks because banks bear much of the direct cost of regulation. In considering regulatory relief proposals, however, policymakers may want to consider not just the benefits of providing relief to small banks, but also the potential positive or negative effects that relief would have on consumers, market stability, and the safety and soundness of the banking system.

In some cases, congressional action is not necessary for small bank relief to occur in the future because regulators often have the authority to establish exemptions and to adjust the tailoring of rules. Without congressional action, however, exemptions and tailoring are likely to continue to occur on an ad hoc and inconsistent basis, for better or worse.

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